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NORWEST BANKS

NORWEST BANK MINNEAPOLIS, N.A.

ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT - DR. SUNG WON SOHN, CHIEF ECONOMIST NOVEMBER 10, 1983

Highlights

- Bankers indicate that their top farm customers–in terms of gross sales–are in better financial shape than a year ago, while many of the highly leveraged farmers still face serious financial problems. The PIK program has succeeded in extending the stay of some of these customers for perhaps only one more year.

- Farmers are likely to increase machinery and equipment purchases, but bankers feel they will remain cautious, concentrating on paying-down debt first.

- While the price of good-quality land in aggressive farming areas has stabilized, the price of lower-quality land tends to be down from a year ago. Fairly stable land prices are projected during the next 12 months.

- Although weak, farm loan demand held up better than expected, given the widespread participation in the PIK program. Banks are starting to recapture some of the market share previously lost to Production Credit Associations. Loan demand is expected to receive a boost from fewer idled acres and somewhat improved capital spending in 1984.

- Employment in the Twin Cities has grown over 2 percent since December's low, on par with the national recovery. The local economy will continue to pick up steam. Signs of recovery are emerging in some northern Minnesota-Wisconsin communities. However, taconite-producing areas do not anticipate improvement before mid-19[illegible].

- Continued weak loan demand, fairly robust deposit growth and improved loan-repayment rates characterize credit conditions in both the Twin Cities and northern Minnesota-Wisconsin. With the exception of Iron Range communities, bankers look for improving loan demand during the next six months.

Fall 1983 Regional Economic Survey

Despite improving vital signs, the regional recovery trails the galloping national economy. Continued weakness in Iowa, Montana and Nebraska has limited regional employment gains. However, healthier conditions are forecast for 1984.

Twin Cities bankers a e the most optimistic as the local recovery continues to pick up momentum. Although agricultural bankers are divided on the economic prospects for 1984, many look for improving conditions. But 1984 will be far from a boom year, as financial problems linger. Meanwhile, some northeastern Minnesota communities anticipate a difficult winter.

This report presents the results of Norwest Banks' 15th semiannual survey of the region's bankers. The survey, conducted in early October, drew responses from about 700 bankers in Iowa, Minnesota, Montana, Nebraska, North Dakota, South Dakota and Wisconsin.

Economic Conditions

Agricultural Communities: Farm earnings in the region are highly variable, depending on crop yields and the relative importance of livestock and dairy operations. Some farmers are cashing in on high prices and good yields; others face serious crop losses. More numerous cases involve higher prices at least offsetting reduced yields. Meanwhile, higher feed costs and low prices have produced significant losses for cattle feeders, creating considerable stress for ranchers as well. Hog producers are also experiencing some red ink, while escalating feed costs and declining milk-price supports have made dairy operations less profitable.

Overall, half of the agricultural bankers reported higher farm income than a year ago, while one-fourth indicated income has declined. Higher income was most prevalent in Minnesota and North Dakota, while substantial numbers of bankers from western South Dakota, eastern Montana and Wisconsin said farm earnings had slipped below last year's level.

Two-thirds of the bankers said the top 20 percent of their farm customers (in terms of gr[illegible] sales) were in better financial shape today than a year ago. Only 10 percent felt these larger farmers were in worse shape. Results for the moderate-to-low leveraged customers were somewhat less favorable, while the consensus was that highly leveraged customers were in worse financial shape than a year ago.

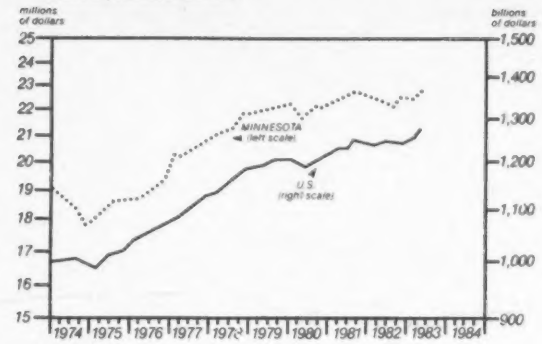
This appraisal, however, was not shared by all. Bankers from eastern North Dakota and Minnesota's grain-oriented areas indicated that even their highly leveraged customers had a chance to improve their financial position this year. Bankers estimate that nearly one-fourth of their farm customers were highly leveraged, although the median response was somewhat less than that.

According to the bankers, cropland and pastureland prices are down an average of 5 percent from a year ago, but considerable variation was reported. One-fourth of the bankers estimated that cropland prices declined 10 percent or more, while half of the bankers reported stable to moderately higher land prices. Prices of poorer-quality land tended to be down, while prices of good-quality land had stabilized. Most bankers expect land prices to remain stable during the next 12 months; however, about one-third of the bankers in western South Dakota, Montana and Wisconsin forecast declining land values.

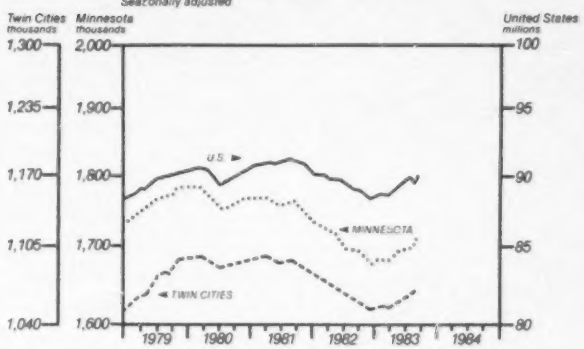
REGIONAL ECONOMIC CONDITIONS

U.S.
MINNESOTA
TWIN CITIES

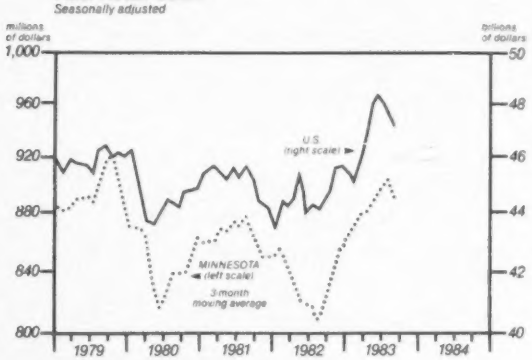
Real Personal Income
Seasonally adjusted annual rates


millions of dollars
billions of dollars
MINNESOTA (left scale)
U.S. (right scale)
1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984

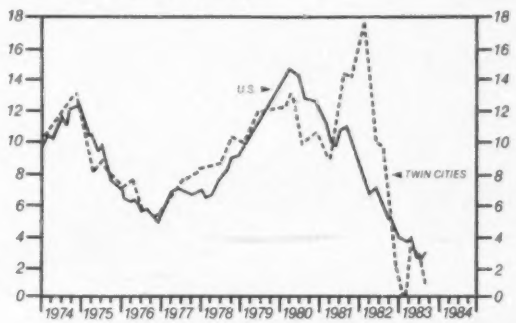
Nonfarm Employment
Seasonally adjusted



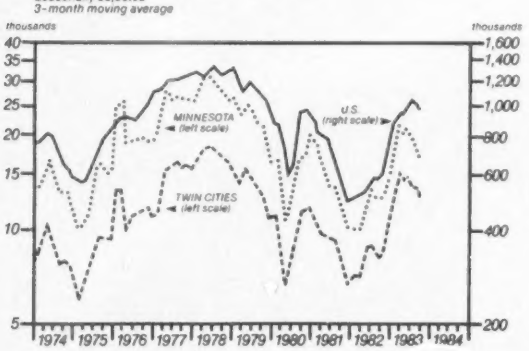
Real Retail Sales
Seasonally adjusted



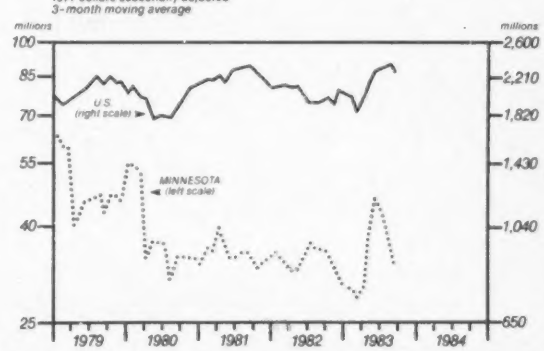
Consumer Price Index
Percent change from a year ago



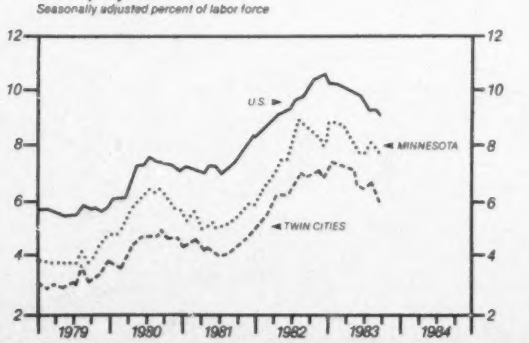
Housing Units Authorized
Building permits issued for 1-4 family units
Seasonally adjusted
3-month moving average



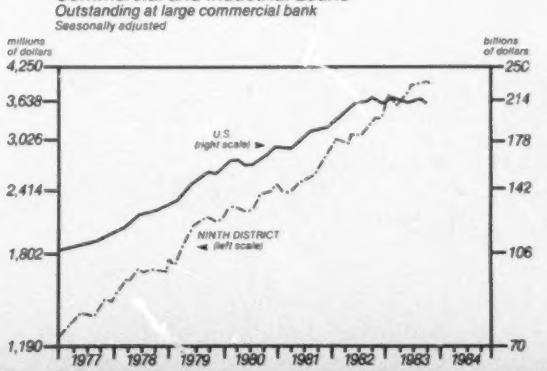
Total Private Nonresidential Construction
Building permits issued
1977 dollars; seasonally adjusted
3-month moving average



Unemployment Rates
Seasonally adjusted percent of labor force



Commercial and Industrial Loans
Outstanding at large commercial bank
Seasonally adjusted


millions of dollars
billions of dollars
U.S. (right scale)
NINTH DISTRICT (left scale)
1977 1978 1979 1980 1981 1982 1983 1984

BEST AVAILABLE COPY

Fall 1983 Regional Economic Survey

Conducted by:
Norwest Bank Des Moines, N.A.
Norwest Bank Minneapolis, N.A.
Norwest Bank Omaha, N.A.

Credit Conditions

Unless otherwise indicated, data show percent of bankers falling in each of the categories higher, same, lower, etc. Items may not add up to 100 percent due to rounding.

1. What is your current **loan-to-deposit** ratio?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	58.4%	50.0%	59.3%	67.0%
Minnesota	60.6	54.0	61.0	68.7
North Dakota	53.6	45.0	54.5	62.1
South Dakota	53.4	44.0	54.0	63.0
Eastern Montana	60.0	49.5	60.0	73.5
Wisconsin	61.9	58.0	62.0	67.5
Iowa	54.5	47.3	55.5	61.5
Nebraska	64.5	55.2	65.0	75.4
Twin Cities Banks	63.3	55.0	62.0	72.0
N. Minn.-Wisc.	60.8	55.0	61.0	70.0
Western Montana	62.0	60.0	60.0	66.3

2. **Loan-to-deposit ratio** higher or lower than desired?

	Higher	Desired	Lower
All Ag Banks	10%	35%	55%
Minnesota	9	38	53
North Dakota	7	34	59
South Dakota	13	35	52
Eastern Montana	21	29	50
Wisconsin	4	38	58
Iowa	6	27	67
Nebraska	18	40	43
Twin Cities Banks	4	29	67
N. Minn.-Wisc.	11	34	55
Western Montana	10	60	30

3. **Typical interest rate** charged for operating loans?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	14.0%	13.5%	14.0%	14.5%
Minnesota	13.9	13.5	14.0	14.3
North Dakota	14.0	13.5	14.0	14.5
South Dakota	14.2	14.0	14.0	14.5
Eastern Montana	13.8	13.5	13.8	14.1
Wisconsin	13.8	13.3	13.8	14.0
Iowa	14.2	14.0	14.3	14.5
Nebraska	13.9	13.5	13.8	14.1
Twin Cities Banks	13.4	13.0	13.0	14.0
N. Minn.-Wisc.	14.0	13.5	14.0	14.5
Western Montana	14.3	13.5	14.0	15.0

4. Percentage change in **loan volume** during past 12 months?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	2.9%	0.0%	0.0%	10.0%
Minnesota	4.1	0.0	2.0	10.0
North Dakota	1.4	-1.5	0.0	6.0
South Dakota	1.6	0.0	0.0	7.5
Eastern Montana	2.7	-3.5	2.5	9.0
Wisconsin	3.9	-1.5	4.5	10.5
Iowa	1.1	-1.5	0.0	7.0
Nebraska	4.5	0.0	5.0	10.2
Twin Cities Banks	3.9	0.0	3.0	10.0
N. Minn.-Wisc.	3.1	0.0	0.0	5.0
Western Montana	4.6	3.0	5.0	12.5

5. Are customers **repaying loans** at a faster or slower rate?

	Faster	Same	Slower
All Ag Banks	13%	68%	19%
Minnesota	14	74	12
North Dakota	21	73	6
South Dakota	15	63	21
Eastern Montana	8	54	38
Wisconsin	9	57	35
Iowa	14	64	22
Nebraska	4	68	28
Twin Cities Banks	18	78	4
N. Minn.-Wisc.	16	74	11
Western Montana	20	70	10

6. Did your bank **sell participations** to PCAs in past 3 months?

	Yes	No
All Ag Banks	4%	96%
Minnesota	3	97
North Dakota	6	94
South Dakota	2	98
Eastern Montana	0	100
Wisconsin	13	88
Iowa	2	98
Nebraska	3	97

7a. Change expected in **agricultural loans** during **next 12 months**?

	Higher	Same	Lower
All Ag Banks	43%	48%	9%
Minnesota	41	53	6
North Dakota	42	53	5
South Dakota	35	53	12
Eastern Montana	17	67	17
Wisconsin	42	42	17
Iowa	52	38	10
Nebraska	56	37	7

7b. Change expected in **commercial and industrial loans** in next 6 months?

	Higher	Same	Lower
Twin Cities	47%	47%	6%
N. Minn.-Wisc.	11	61	29
Western Montana	40	40	20

7c. Change expected in **total loan volume**?

	Higher	Same	Lower
All Ag Banks	47%	46%	7%
Minnesota	45	49	6
North Dakota	55	39	6
South Dakota	42	52	6
Eastern Montana	38	54	8
Wisconsin	50	46	4
Iowa	46	46	7
Nebraska	53	38	9
Twin Cities Banks	53	43	4
N. Minn.-Wisc.	24	53	24
Western Montana	50	30	20

8. Anticipated trend in **loan-to-deposit ratio** during **next 12 months**?

	Higher	Same	Lower
All Ag Banks	46%	40%	14%
Minnesota	44	45	11
North Dakota	55	39	6
South Dakota	45	37	18
Eastern Montana	46	38	17
Wisconsin	67	21	13
Iowa	45	39	15
Nebraska	40	39	21
Twin Cities Banks	51	45	4
N. Minn.-Wisc.	21	53	26
Western Montana	30	40	30

9. Percentage increase in **bank deposits** during past 12 months?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	7.6%	4.0%	8.0%	10.0%
Minnesota	8.2	5.0	9.0	10.0
North Dakota	6.9	2.0	7.0	10.0
South Dakota	5.1	0.0	5.5	10.0
Eastern Montana	8.2	6.0	7.5	10.0
Wisconsin	8.8	6.0	8.0	12.0
Iowa	7.7	5.0	8.0	10.0
Nebraska	7.7	5.0	10.0	12.0
Twin Cities Banks	11.6	8.0	10.0	17.0
N. Minn.-Wisc.	9.1	5.0	10.0	13.3
Western Montana	3.3	0.0	5.0	11.7

10. **Anticipated deposit growth** during next 12 months?

	Stronger	Average	Weaker
All Ag Banks	25%	65%	11%
Minnesota	26	63	12
North Dakota	21	68	11
South Dakota	25	58	17
Eastern Montana	17	75	8
Wisconsin	8	79	13
Iowa	31	62	7
Nebraska	24	68	9
Twin Cities Banks	27	67	6
N. Minn.-Wisc.	13	74	13
Western Montana	30	60	10

Business Conditions

11. Is **farm/ranch income** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	50%	27%	23%
Minnesota	65	21	14
North Dakota	59	22	19
South Dakota	40	40	19
Eastern Montana	21	25	54
Wisconsin	0	21	79
Iowa	49	29	22
Nebraska	40	36	24

12. Change expected in **farm income** during **next 12 months**?

	Higher	Same	Lower
All Ag Banks	33%	49%	18%
Minnesota	43	42	15
North Dakota	21	68	11
South Dakota	27	56	17
Eastern Montana	21	33	46
Wisconsin	0	46	54
Iowa	44	43	12
Nebraska	25	59	16

13a. Percentage change in **cropland prices** from a year ago?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	-5.1%	-10.0%	0.0%	0.0%
Minnesota	-4.7	-10.0	0.0	0.0
North Dakota	-3.3	-5.0	0.0	0.0
South Dakota	-5.8	-10.0	0.0	0.0
Eastern Montana	-3.3	-7.5	0.0	0.0
Wisconsin	-4.9	-10.0	-3.0	0.0
Iowa	-6.3	-10.0	-5.0	0.0
Nebraska	-6.5	-10.0	-5.0	0.0

13b. Percentage change in **pastureland prices** from a year ago?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	-5.6%	-10.0%	0.0%	0.0%
Minnesota	-4.8	-10.0	0.0	0.0
North Dakota	-3.0	-5.0	0.0	0.0
South Dakota	-7.2	-10.0	-5.0	0.0
Eastern Montana	-4.0	-7.5	0.0	0.0
Wisconsin	-5.1	-10.0	0.0	0.0
Iowa	-7.1	-10.0	0.0	0.0
Nebraska	-7.2	-15.0	-6.0	0.0

14. Anticipated trend in **land prices** during **next 12 months**?

	Increase	Stable	Decrease
All Ag Banks	14%	70%	16%
Minnesota	19	69	11
North Dakota	6	78	16
South Dakota	12	67	22
Eastern Montana	0	71	29
Wisconsin	0	67	33
Iowa	18	69	12
Nebraska	12	68	21

15. Are **capital expenditures** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	10%	35%	55%
Minnesota	16	39	46
North Dakota	10	48	43
South Dakota	12	25	63
Eastern Montana	4	42	54
Wisconsin	4	21	75
Iowa	8	32	60
Nebraska	4	28	68
Twin Cities Banks	35	53	12
N. Minn.-Wisc.	11	50	39
Western Montana	20	50	30

16. Change expected in **capital outlays** during **next 12 months**?

	Stronger	Same	Lower
All Ag Banks	24%	51%	24%
Minnesota	32	51	17
North Dakota	24	59	17
South Dakota	10	62	29
Eastern Montana	4	67	29
Wisconsin	8	50	42
Iowa	30	43	26
Nebraska	19	46	35
Twin Cities Banks	41	55	4
N. Minn.-Wisc.	11	47	42
Western Montana	30	40	30

17. Are **retail sales** better or worse than a year ago?

	Better	Same	Worse
All Ag Banks	25%	48%	27%
Minnesota	32	48	20
North Dakota	38	41	21
South Dakota	23	42	35
Eastern Montana	17	38	46
Wisconsin	33	38	29
Iowa	15	60	25
Nebraska	13	46	41
Twin Cities Banks	76	22	2
N. Minn.-Wisc.	66	29	2
Western Montana	40	30	30

18. Are **automobile sales** better or worse than a year ago?

	Better	Same	Worse
Twin Cities Banks	88%	12%	0%
N. Minn.-Wisc.	76	21	3
Western Montana	78	22	0

19. Change expected in **consumer spending** during **next six months**?

	Stronger	Same	Weaker
Twin Cities Banks	71%	29%	0%
N. Minn.-Wisc.	26	55	18
Western Montana	10	80	10

20. Are **housing starts** better or worse than a year ago?

	Better	Same	Worse
Twin Cities Banks	65%	31%	4%
N. Minn.-Wisc.	47	37	16
Western Montana	40	40	20

21. Anticipated trend in **economic conditions** during **next six months**?

	Better	Same	Worse
All Ag Banks	43%	47%	10%
Minnesota	49	43	8
North Dakota	35	54	11
South Dakota	38	48	13
Eastern Montana	29	46	25
Wisconsin	33	54	13
Iowa	51	41	8
Nebraksa	32	59	9
Twin Cities Banks	59	39	2
N. Minn.-Wisc.	21	63	16
Western Montana	50	20	30

22a. Financial condition of **highly-leveraged** farm customers compared with a year ago?

	Much Better	Slightly Better	About Same	Slightly Worse	Much Worse
All Ag Banks	1%	25%	28%	35%	13%
Minnesota	1	30	31	32	6
North Dakota	0	33	26	36	5
South Dakota	0	23	21	40	15
Eastern Montana	4	9	13	48	26
Wisconsin	0	13	25	38	25
Iowa	1	26	20	34	20
Nebraska	0	11	41	32	17

22b. Financial condition of **moderate-to-low leveraged** farm customers compared with a year ago?

	Much Better	Slightly Better	About Same	Slightly Worse	Much Worse
All Ag Banks	7%	34%	37%	20%	2%
Minnesota	10	44	33	12	1
North Dakota	2	35	44	19	0
South Dakota	4	26	44	26	0
Eastern Montana	13	9	30	39	9
Wisconsin	4	13	46	29	8
Iowa	9	31	35	22	3
Nebraska	1	34	37	25	1

22c. Financial condition of **top 20 percent of farm customers** (by gross sales) compared with a year ago?

	Much Better	Slightly Better	About Same	Slightly Worse	Much Worse
All Ag Banks	19%	48%	24%	9%	1%
Minnesota	26	48	23	2	1
North Dakota	11	55	26	8	0
South Dakota	6	56	25	12	2
Eastern Montana	4	35	30	30	0
Wisconsin	4	38	33	21	4
Iowa	25	51	19	5	1
Nebraska	17	36	30	17	0

23a. Percentage of farm customers that are **highly leveraged?**

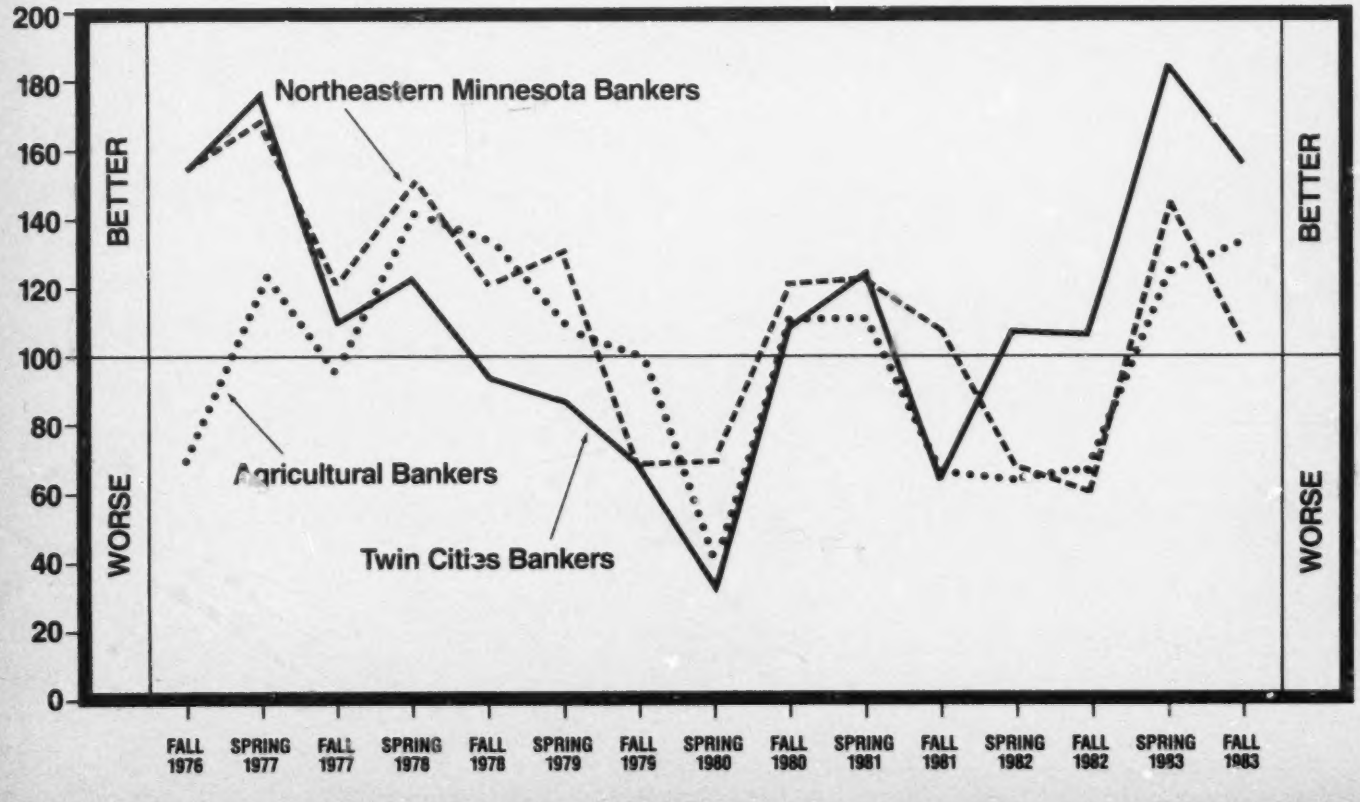
	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	24.0%	10.0%	20.0%	30.0%
Minnesota	20.9	10.0	20.0	30.0
North Dakota	28.3	12.5	20.0	31.5
South Dakota	28.4	15.0	25.0	50.0
Eastern Montana	26.8	10.0	20.0	36.7
Wisconsin	23.8	10.0	20.0	30.0
Iowa	23.9	10.0	20.0	30.0
Nebraska	24.6	10.0	20.0	30.0

23b. Percentage of farm customers that are **moderate-to-low leveraged?**

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	49.7%	30.0%	50.0%	70.0%
Minnesota	54.7	30.0	60.0	75.0
North Dakota	45.7	25.0	40.0	60.0
South Dakota	44.6	22.5	41.0	66.3
Eastern Montana	52.9	25.0	60.0	77.5
Wisconsin	49.3	30.0	50.0	60.0
Iowa	47.0	25.0	47.5	70.0
Nebraska	47.0	29.0	40.0	70.0

UPPER MIDWEST CONFIDENCE INDEX

Percent of bankers expecting economic conditions to improve
minus percent expecting conditions to deteriorate during the next six months plus 100.



Bankers are divided on the economic prospects for 1984. Some expect marked improvement. Others anticipate rough times. On balance, over 40 percent of the agricultural bankers look for improving conditions next year, while nearly half foresee little change. Within the region, Iowa and Minnesota bankers were the most optimistic.

Crop prices are expected to decline under the weight of a big jump in acreage next year, but bankers anticipate a rebound in livestock prices which, along with lower feed costs, should brighten returns to livestock feeders. Diminishing profits are forecast for dairy producers, although the outlook is still ambiguous because of potential changes in dairy legislation. Weighing all factors, many agricultural communities are likely to experience steady improvement in 1984, but it will be far from a boom year. Many financially stressed producers will remain under pressure, with some highly leveraged operators going out of business.

Only one-fourth of the bankers anticipate farmers will increase capital outlays during the next 12 months. An identical number anticipate less spending. Again, bankers in Minnesota and Iowa were a little more bullish. Although some bankers expect moderate increases in farm-machinery and equipment sales, they felt farmers would be cautious, concentrating on paying-down debt first. However, farmers are expected to increase outlays for seed, fertilizer and chemicals, as considerably fewer acres will be idled next year.

Twin Cities: The economic recovery that began early this year continues to gain momentum. General retail and auto sales are stronger than a year ago, and housing starts have rebounded sharply from last year's meager level. Bankers also indicate that capital expenditures by businesses are starting to pick up.

Nonfarm employment in September was nearly 23,000 higher than last December's low, a gain of 2 percent, on par with the national recovery. So far, the Twin Cities has regained half of the jobs lost during the recession, but not all business sectors have noticed improvement. Expansion has also been concentrated in different areas than nationally. Construction and wholesale-and retail-trade employment has rebounded more rapidly in the Twin Cities, while manufacturing and health-and business-services employment has grown more slowly than the national average.

Most Twin Cities bankers forecast continued improvement next year. However, some expected only moderate improvement, while others look for a strong rebound in 1984.

Northern Minnesota/Wisconsin: Some signs of an economic recovery are evident. Although capital spending remains in the doldrums, auto and general-retail sales are better than a year ago. However, wide variation is evident in this region as well.

Iron Range bankers were the least hopeful. They expect several taconite plants to be shut down for the entire winter. Consequently, they do not look for a turnaround in economic activity until mid-1984. Even then, the bankers feel it will take considerable time for their communities to adjust to a permanently lower level of employment.

Bankers in other northern Minnesota communities were more optimistic. They report a slow recovery is under way and expect gradually improving conditions next year. Northern Wisconsin bankers were even more optimistic. Nearly all of them said economic conditions were better than year ago. They foresee continued improvement during 1984.

Western Montana: Although guarded, bankers in western Montana were more optimistic than their counterparts in the predominantly agricultural communities in eastern Montana. Retail sales, auto sales and housing starts were all reported stronger than a year ago, but capital expenditures remain weak.

Half of the bankers anticipated further improvement in economic conditions during the next six months. A major factor will be further growth in the lumber and wood product industries. Tourism will also boost Montana's economy.

Bankers sum up the prospects for 1984 as follows:

Minnesota *- "Our immediate area is harvesting an average to better-than-average crop, and with current prices the area should receive a boost from farm spending and ag-related business spending."*

"Overall outlook in comparison to last year is very positive."

"Agriculture will have to have at least two more good years before marked improvement will be felt."

"Farmers with low debts are doing very well and can weather the lower milk prices."

North Dakota *- "A little better than 1983. Farmers making capital purchases only when necessary."*

"Better but still tough for many farmers."

"Bleak! Have had 2-3 years of severe drought!"

South Dakota *- "Farm sector should begin to improve in late 1984 when cattle and hog cycles turn."*

"About the same to slightly better."

"Farmers with a good loan-to-asset ratio will remain stable--gain very little. Farmers with a poor loan-to-asset ratio will have trouble--possible liquidation."

Montana *- "Very little improvement."*

"Need substantial increase in cattle prices to do any good for local economy in 1984."

Wisconsin *- "Reduction in price support for milk will hurt the highly leveraged farmers. Moderate-to-low leveraged will be okay. Retail sales should be strong again as tourist business has improved."*

"Lower dairy income will tend to hold down economic expansion."

Iowa *- "Better, but still no great turnaround."*

"Farm economy will be good for those who market well (early). Livestock people will see a good year--especially second half of '84 when crop prices have taken a tumble."

"Drought loss will take some time for our customers to recover."

"Farmers' attitudes are better, but I don't think they will be spending much money. They will attempt to pay off debts and build a financial cushion..."

Nebraska *- "This window we have seen this year has not helped the highly leveraged farmers, just extended their stay maybe one more year..."*

"Look for 1984 to remain unchanged to a little better."

"Will just be an average year."

Twin Cities *- "Expecting a good year."*

"Profit projections of customers are stronger than last year. Consumer expectations appear to be better."

"Stronger, but with reservation. Not all business sectors have noticed an improvement this fall."

Northern Minnesota/Wisconsin - *"Should continue to improve slowly during the next 12 months.*

"Some slight upturn in 1984 anticipated."

Iron Range - *"The next six months will be tough. We don't look for a turnaround until late spring or early summer."*

"I believe the first quarter will be very poor but slowly improving the following three quarters."

Credit Conditions

Agricultural Banks: Credit conditions at agricultural banks are characterized by better loan-repayment rates, sluggish (but perhaps improving) loan demand and ample funds for lending to qualified customers.

Total loan volume was up a modest 3 percent from a year ago. Although sluggish, this performance suggests that farm-loan demand at banks held up better than had been expected with the widespread farmer participation in the PIK program and the associated decline in purchases of fuel, seeds, fertilizer and chemicals.

One explanation for this is that banks are starting to recapture some of the market share previously lost to Production Credit Associations (PCAs). Nationwide, the volume of nonreal-estate farm loans held by PCAs at the end of August was down 8.8 percent from a year ago. At the end of August, PCAs were lending money to nearly 7 percent fewer customers than a year earlier.

During the past three months, only 4 percent of the banks reported selling participations (loans) to PCAs, down from 20 percent a few years ago. Among individual states, the proportion of banks selling participations to PCAs range from zero in Montana to 13 percent in Wisconsin.

Loan-to-deposit ratios at agricultural banks edged up a slight six-tenths of 1 point during the past six months. This is less than the normal seasonal increase. At 58.4 percent, the average ratio in early October was 1.1 points less than a year ago. Twenty-five percent of the banks had a loan-to-deposit ratio of 50 percent or lower, while 25 percent had a ratio of 67 percent or higher. Over half of the bankers considered their ratio lower than desired, while only 10 percent viewed their ratio as higher than desired.

Farm-loan repayment rates improved during the past six months, continuing a trend that emerged last spring. Only 19 percent of the bankers said customers were repaying loans at a slower rate than a year ago, down substantially from 42 percent last spring and 62 percent last fall. This reflects improved farm earnings and a decline in production expenses due to the PIK program.

Interest rates on farm operating loans averaged 14 percent in October, the same rate as last April, but down nearly 2 points from a year ago. Rates had dipped below 14 percent in the second quarter, but firmed during the summer months.

Deposits at agricultural banks are up 7.6 percent from a year ago. Deposit growth appears to have slowed somewhat in recent months, after having spurted ahead earlier this year following the introduction of the new money-market accounts. Bankers expect deposit growth to be slightly stronger than average during the next 12 months.

Loan demand is also expected to strengthen in 1984. Farm operating loans are projected to increase as fewer acres are idled next spring. Additional capital spending will also boost loan demand in some localities. As a result, nearly half of the bankers expect their loan-to-deposit ratios to rise during the coming year.

Twin Cities: Sluggish loan demand prevails at Twin Cities banks. Total loans outstanding are up only 3.9 percent from a year ago. Meanwhile, although growth has slowed from last spring's rapid pace, deposits are up 11.6 percent from last year. Loan repayment rates continued to improve during the past six months and are up substantially from last fall.

The average loan-to-deposit ratio inched up to 63.3 percent, only one point higher than last spring. One-fourth of the banks had a ratio of 55 percent or less, while another one-fourth had a ratio of 72 percent or more. Two-thirds of the bankers viewed their ratio as lower than desired, the largest proportion since this survey began in October 1976.

Interest rates for operating loans averaged 13.4 percent in early October at Twin Cities banks, up slightly from last spring but down more than two points from a year ago.

About half of the Twin Cities bankers expect stronger loan demand during the next six months, along with higher loan-to-deposit ratios. Few bankers anticipate weaker loan demand.

Northern Minnesota/Wisconsin: Continued weak loan demand and fairly robust deposit growth characterize credit conditions. Loan volume is up an average of 3.1 percent from a year ago, but Iron Range bankers reported a 1.6 percent decline. Deposits increased a fairly strong 9.1 percent during the past year. Iron Range banks shared in this growth.

The average loan-to-deposit ratio crept up one point since April to 60.8 percent, but remains 10 points below the peak set in October 1979. Many bankers considered their ratio as lower than desired.

Interest rates charged for operating loans averaged 14 percent in October, up a mere two-tenths of 1 percent since last spring. With the exception of Iron Range communities, customers were repaying loans at a faster rate than a year ago.

Iron Range bankers expect loan demand to remain weak during the next six months, while other bankers in this northern region anticipate modest growth. Loan-to-deposit ratios are projected to follow a similar pattern.

Western Montana: Weak loan demand also is evident in western Montana. Bankers indicate loan volume is up 4.6 percent from a year ago. Deposits grew a modest 3.3 percent, weaker than most other areas included in this survey.

Loan-to-deposit ratio averaged 62 percent, up 3.3 points from last spring. This change could be misleading since the median response declined slightly. However, only 30 percent of the bankers viewed their ratios as lower than desired. Loan repayment rates were slightly faster than a year ago, while the average interest rate charged for operating loans was 14.3 percent in October.

Montana bankers expect loan demand will increase during the next six months, but loan-to-deposit ratios are forecast to remain near current levels.

by Dr. Larry J. Wipf
Vice President and
Director of Regional Economics

Indicators is a publication of the Economics Department of Norwest Bank Minneapolis, N.A. For further information, contact Dr. Sung Won Sohn, Senior Vice President and Chief Economist, (612) 372-7871; Dr. Richard Smith, Vice President, Director of International Economics, (612) 372-5845; Dr. Larry J. Wipf, Vice President, Director of Regional Economics, (612) 372-9281; or Janet Grant, Communications Officer, Corporate Communications, (612) 372-6704.

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NORWEST BANKS

NORWEST BANK MINNEAPOLIS, N.A.

ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT - DR. SUNG WON SOHN, CHIEF ECONOMIST JANUARY 18, 1984

Highlights

- The economy will slow to noninflationary growth. The question is whether it will do it alone or the Federal Reserve will have to boost interest rates to cool the economy. We believe that the current level of interest rates are high enough so that the money managers won't have to act.

- Later in the year, interest rates will begin to rise. Credit demand from businesses and consumers will rise. The Federal government will borrow huge sums in private credit markets. Interest rates will have to go up to induce interest-sensitive commercial banks and pension funds to absorb a bigger share of the federal debt.

- Despite higher interest rates, the value of the dollar will begin to weaken. The weight of the large U.S. trade deficit, improving investment opportunities in Europe and the expectation of the weaker dollar are the reasons. The weaker dollar and economic expansion abroad will help exports and trim the trade deficit.

- The key to inflation will be wages. Unions representing about three million workers in major industries will negotiate. Wage negotiations will be difficult because of healthy corporate profits and increasing willingness of union members to strike.

- However, the wage-price spiral is not likely to begin. Tens of thousands of union workers have permanently lost jobs or are on layoffs. Foreign competition in manufacturing industries, deregulation in service industries and the threat of increased automation will act to dampen wage settlements.

What's Ahead for 1984?

Happy birthday! The infant economic recovery is one year old. As most one-year-olds do, the baby has grown a lot. The surprise was that the infant has been so healthy and bouncy despite the poor diet of high interest rates and record federal deficits. Do economic doctors have a good explanation for the surprise? Will the child progress as much this year as it did last year?

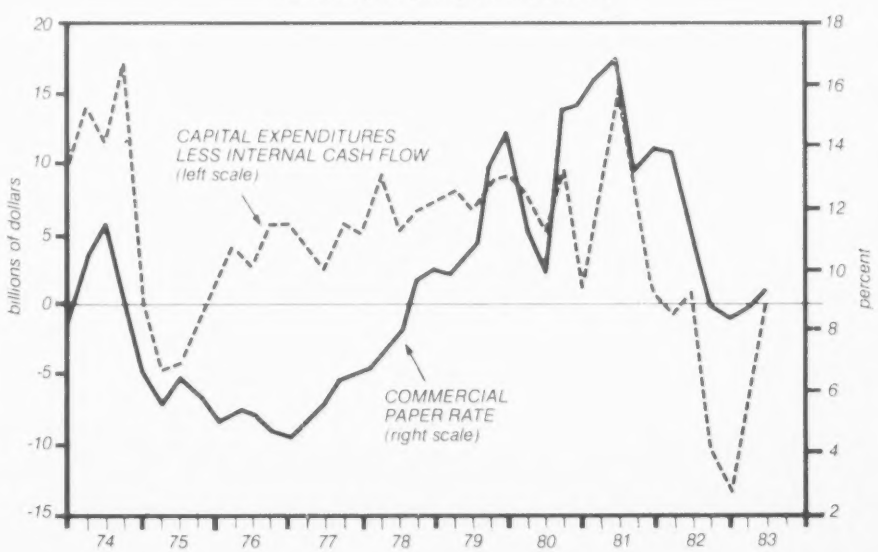
Last year, the economy was awash in liquidity; consequently, the bite of high interest rates was mitigated. As Chart 1, shows, internal cash flows for businesses exceeded capital expenditures by a substantial margin. The major portion of the cash flow came from corporate profits, which benefited from strong sales, cyclical advances in labor productivity, spreading of fixed costs over more units of production and excellent cost control. Uncle Sam helped out as well. The corporate-tax cuts and greater depreciation resulting from the Economic Recovery Tax Act of 1981 reduced corporate tax liabilities. Of course, federal deficits went up by the same amount.

Expenditures were limited to replacing equipment neglected during economic recessions and purchasing of machines designated to control cost through automation and computerization. Unexpectedly strong sales did not allow businesses time to build inventory stocks, reducing working capital needs.

Similarly, consumer liquidity was good. During tough economic times, individuals saved for the rainy days. Fortunately, the weather turned sunny. Production, employment and overtime rose, and the income gains were solid. The booming stock and bond markets over the past two years added to consumer wealth. The consumers also had plenty of borrowing power. Around year-end, the ratio of consumer installment debt

CHART 1

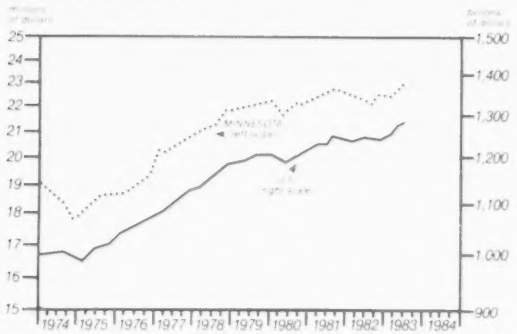
Credit Market Pressure



REGIONAL ECONOMIC CONDITIONS

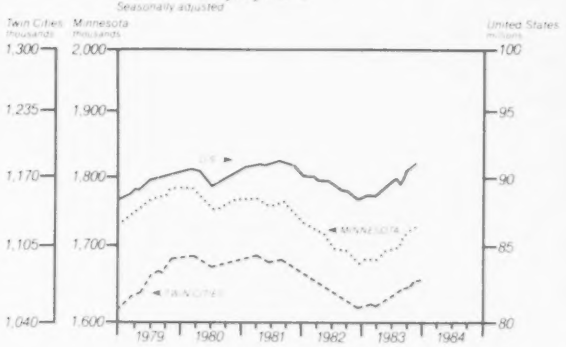
Real Personal Income

Seasonally adjusted annual rates



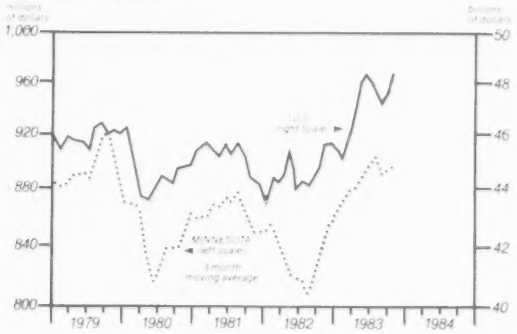
Nonfarm Employment

Seasonally adjusted



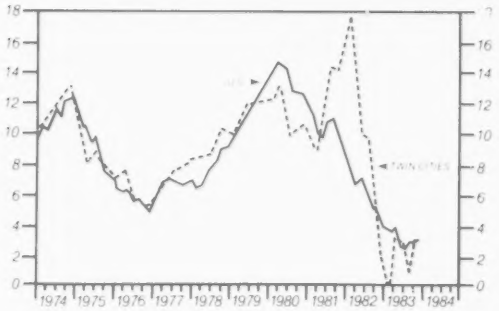
Real Retail Sales

Seasonally adjusted



Consumer Price Index

Percent change from a year ago

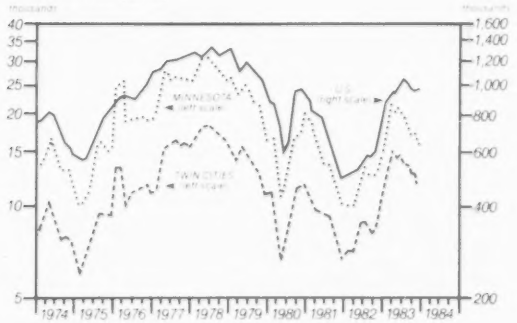


Housing Units Authorized

Building permits issued for 1–4 family units

Seasonally adjusted

3-month moving average

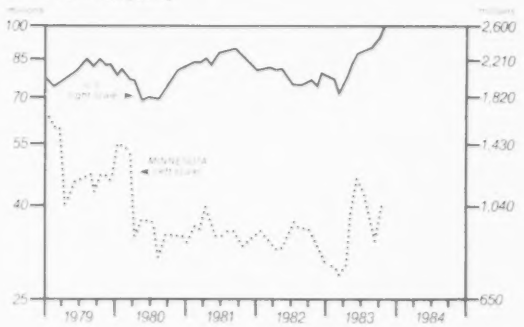


Total Private Nonresidential Construction

Building permits issued

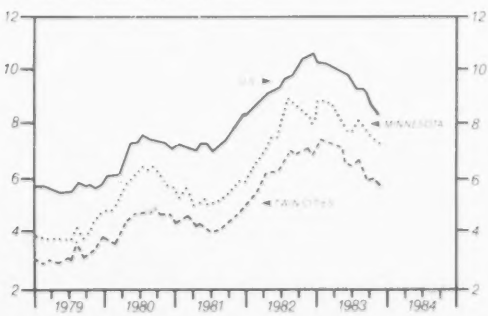
1977 dollars seasonally adjusted

3-month moving average



Unemployment Rates

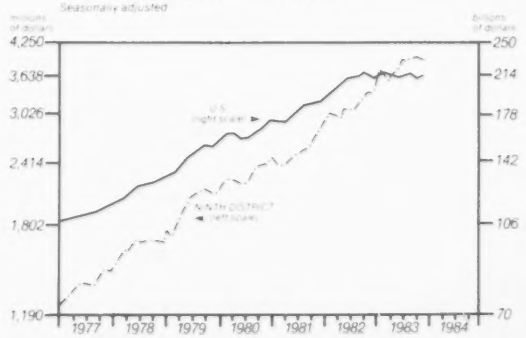
Seasonally adjusted percent of labor force



Commercial and Industrial Loans

Outstanding at large commercial banks

Seasonally adjusted



outstanding to take-home pay stood at 15.4 percent, up from the 15.1 percent low one year ago, but well below the 17.8 percent peak in 1979.

As evidenced by the $185 billion deficit, the federal government did its share. Expenditures increased due to authorizations already made for defense spending, the disappointing action on trimming entitlement programs and surging interest costs. Since spending and borrowing by the federal government are interest-insensitive, high interest rates had little effect on government spending.

ECONOMIC OUTLOOK

	1983	1984
Real GNP*	4.9	4.2
CPI-Urban*	3.4	5.5
Unemployment Rate (Percent)	9.5	7.6
Car Sales (Mil. Units)	9.1	10.3
Housing Starts (Mil. Units)	1.7	1.8
Federal Deficit (Billion $)	180	175

*** 4Q 1983 to 4Q 1984 Percent Change**

The international sector added to U.S. liquidity. The strong dollar and foreign funds looking for "safe haven" increased liquidity in the United States.

For these reasons, high interest rates and federal deficits had limited influence on the 1983 economy. Will the pattern hold this year? Not likely!

As 1984 unfolds, liquidity will diminish, making the economy more susceptible to high interest rates.

For nonfinancial businesses, internal cash flow will continue to be healthy, but expenditures on capital spending and inventories will exceed the cash flow. Unlike last year, businesses will have to raise funds from external sources in order to meet spending plans.

Consumers also will borrow more heavily from external sources, making them more sensitive to interest rates. Rising employment and income, as well as favorable psychology, bode well for increased consumer spending and borrowing. At the moment, the portion of consumers' income going to service debt is relatively low. With additional installment and mortgage debts, the debt-service burden will rise.

Unfortunately, the federal government will go on spending merrily regardless of interest rates. The common philosophy is: "No politician in sound mind would want to cut spending and/or raise taxes in an election year." The nation will suffer through another year with deficits close to $200 billion.

Internationally, there is hope that the dollar will begin to depreciate. The huge trade deficit should affect the value of the dollar sooner or later. Economic recoveries in Europe are gaining momentum, opening opportunities for investments. Also, the consensus in the foreign-exchange market is that the dollar will weaken. The expectation of a weaker dollar, improving investment opportunities in Europe and the weight of the large U.S. trade deficit should begin to slow capital inflows. Liquidity from the foreign sector will become less and less important.

In short, there are no significant barriers to continuing economic recovery. As the economy becomes less and less liquid, however, the current high interest rates will have greater effects on economic activity. If the current level of interest rates is not high enough to slow economic growth, Chairman Volcker of the Federal Reserve will nudge it higher.

Most likely, the economy will slow to noninflationary growth. The question is whether it will do it alone or need help from the Federal Reserve.

Prices

After more than a decade of accelerating prices, inflation has slowed sharply. The 1983 rate, at slightly over 3 percent, has surprised even the optimists. However, the costs were high. Back-to-back recessions resulted in the highest unemployment rate since the Depression, soaring bankruptcies and a severe strain on the international financial system. Inflation was subdued, but the process was painful and not much fun at all.

Most people believe that the best inflation news is behind us and prices will start inching upward this year, but the question is, how high? The answer will depend upon profit margins, capacity-utilization rates, commodity prices and wages.

Margins are the difference between prices and costs. As shown in Table 1, margins in 1982 were negative. Businesses instituted severe cost controls, significantly lowering the break-even point. Consequently, margins turned positive in 1983. The automobile industry was a good example. In 1983, domestic car sales were about 6.8 million units. In the past, such a low volume would have meant losses for the domestic auto industry. Instead, Detroit enjoyed good profits, thanks to the cost-cutting programs.

TABLE 1
PROFIT MARGINS
(Percent Change)

	1982	1983E	1984F
GNP Deflator	6.0	4.2	5.5
Unit Labor Costs	7.9	2.3	3.0
Margin Proxy	(1.9)	1.9	2.5

E = Estimate
F = Forecast

In the future, margin improvements will have to come from higher prices. With a strong demand for goods and services, businesses will not only be able to pass on higher costs to consumers, but will be able to raise prices to increase margins as well. Our estimate shown in the preceding table indicates that higher prices will increase margins this year, adding to inflationary pressure.

The second important consideration in gauging future inflation is the capacity-utilization rate, which reached a recession low of 69.8 percent in 1982. The rate bounced back rapidly during 1983 to almost 80 percent. Historically, price pressures, bottlenecks and shortages tend to appear as the utilization rate approaches 85 percent. While the rate is expected to remain well below the critical point in 1984, this area needs close watching.

Commodity prices tend to be very volatile. As shown in Table 2, prices increased little in 1983. As the economic recovery proceeds at home and abroad, cyclical demand will increase commodity prices. Stronger economic recoveries in Japan and Europe (large buyers of commodities) particularly will have significant effect on commodity prices. In addition, expected increases in livestock prices will add to the pressure.

TABLE 2
COMMODITY PRICES
(Percent Change)

	1982	1983E	1984F
Finished Goods	4.0	1.8	4.5
Crude Materials	(2.9)	1.4	5.0
Intermediate Materials	1.4	0.7	5.0

E = Estimate
F = Forecast

The most significant effect on inflation will come from wages, which account for roughly two-thirds of total costs.

As shown in Table 3, in 1983, hourly earnings increased 4.6 percent, while compensation, including fringe benefits, rose 5.8 percent. Wages and salaries of blue-collar union workers increased less rapidly than those of nonunion service and technical workers. Blue-collar workers suffered most in those industries that experienced the stiffest competitive pressures and the deepest unemployment.

With rebounding corporate profits and a dropping unemployment rate, the rallying cry for rank-and-file union members will be "Restore and More in '84." This year, unions representing about three million workers will negotiate in the auto, rail, coal, construction, retail food and

TABLE 3

WAGES

(Percent Change)

	1982	1983E	1984F
CPI - All Urban	6.2	3.2	5.5
Hourly Earnings	6.8	4.6	5.0
Hourly Compensation	7.9	5.8	6.3

E = Estimate
F = Forecast

other major industries. Negotiations will be difficult because of healthy profits and increasing willingness by union members to strike.

These considerations, however, do not mean that "give-backs" will become "get-backs" and restart the wage-price spiral. There have been structural changes in the economy. Foreign competition in manufacturing industries, deregulation in service industries and the threat of increased automation will act to dampen wage demands.

In addition, the two recessions in the last four years have greatly weakened unions' bargaining clout. Only about 18 percent of the U.S. labor force belongs to unions, down from 20.5 percent in 1980. Despite the improving economy, tens of thousands of union workers have permanently lost jobs or are on layoffs.

Under the circumstances, some wage "give-backs" will become "get-backs," but the overall wage settlement is expected to be moderate, not exceeding the overall inflation rate.

In conclusion, yes, the best inflation news is behind us. It does not mean, however, that a double-digit rate is looming ahead. The overall inflation rate as measured by the "All-Urban CPI" should be 5 to 6 percent this year.

Interest Rates

Earlier, it was pointed out that the economy will become increasingly interest-sensitive as borrowing needs grow for businesses and consumers. Then the level of interest rates will begin to have a greater effect on the pace of economic activity.

Interest rates are determined by a complex set of forces on both supply and demand sides. For 1984, however, two key elements—external financing needs of businesses and the willingness of the private sector to finance federal deficits—will have major influences on interest rates.

Capital spending will be one of the fastest-growing elements of the economic recovery, but 1984 internal cash flows will be insufficient to meet all the spending needs. Continuing economic expansion, healthy corporate profits, rising capacity-utilization rates and foreign competition will boost capital spending. Inventory building also will add to business financing requirements; this year over $30 billion will be spent to rebuild stocks, compared with runoff of about $5 billion in 1983.

Consequently, businesses will need to raise funds from external sources. Chart 1 on the front page shows that interest rates, represented here by the commercial paper rate, tend to move up when external-financing needs of businesses rise. Given our estimate of borrowing needs, interest rates will receive upward pressure, but not enough to cause a significant increase. Moreover, the upward pressure will not come until toward year-end.

The other key consideration is federal deficits. The size of the deficit is not the only issue; the question is who will purchase the ever-rising supply of Treasury debt.

TABLE 4

DISTRIBUTION OF FEDERAL DEBT

(Percent of Total Held)

	1982	1984F
Federal Reserve	14%	13%
Foreigners	15	16
Individuals	30	28
Commercial Banks	14	15
Pension Funds	4	5
Others	23	23
Total	100	100

F = Forecast

Table 4 shows the distribution of the outstanding federal debt in 1982 as well as an estimate of the distribution for 1984. Only the Federal Reserve and foreign central banks are interest-insensitive holders of Treasury securities; the others are interest-sensitive.

The volume of federal securities held by the Federal Reserve depends upon monetary policy. In order to increase bank reserves and money supply, the money managers purchase Treasury securities. Consequently, the rate of monetary expansion is dependent upon the amount of Treasury securities the Federal Reserve is willing to hold. Given current anti-inflationary monetary policy, the Fed's share is expected to decline to 13 percent this year from 14 percent in 1982.

Foreigners, primarily foreign central banks, are also interest-insensitive. For example, the large U.S. trade deficit increases dollar holdings of foreign central banks, which in turn invest the process in U.S. Treasury securities. Considering the sizable U.S. trade deficit, the foreign central banks will have plenty of dollars to purchase Treasury securities, increasing their share by 1 percent during the period.

Among the interest-sensitive holders, individuals, the largest group holding Treasury securities, will reduce their share. After deregulation, consumers now earn a market rate of return tied to Treasury securities at financial institutions. Consequently, they have less incentive to purchase Treasury issues directly. That leaves the other two major buyers of the federal debt, commercial banks and pension funds.

How can the Treasury induce these two groups to increase their purchases of Treasury securities? Higher interest rates! Interest rates will have to go up enough to crowd out private borrowers, allowing the Treasury to finance federal deficits.

In other words, the mild rise in interest rates toward year-end will be caused by two factors. First of all, the sheer size of the deficit will increase credit-market pressure. In addition, the portion of the debt that has to be purchased by interest-sensitive commercial banks and pension funds will go up, slowly putting additional pressure on interest rates.

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Indicators is a publication of the Economics Department of Norwest Bank Minneapolis, N.A. For further information, contact Dr. Sung Won Sohn, Senior Vice President and Chief Economist, (612) 372-7871; Dr. Richard Smith, Vice President, Director of International Economics, (612) 372-5845; Dr. Larry J. Wipf, Vice President, Director of Regional Economics, (612) 372-9281; or Janet Grant, Communications Officer, Corporate Communications, (612) 372-6704.

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NORWEST BANKS

NORWEST BANK MINNEAPOLIS, N.A.

ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT - DR. SUNG WON SOHN, CHIEF ECONOMIST MARCH 15, 1984

Highlights

- The rise in international economic instability under floating exchange rates has led to several economic proposals to reduce that rise. Professor Ronald McKinnon suggests that stability be regained through international coordination of monetary policies designed to restore stable exchange rates.

- The gold standard provided an automatic adjustment mechanism for correcting balance-of-payments and exchange-rate problems. It collapsed, however, when countries with balance-of-payments surpluses refused to inflate their economies. The adjustment burden thus fell heavily on deficit countries.

- The Bretton Woods system attempted to correct the deficiencies of the gold standard. Under this system, the International Monetary Fund was to ensure orderly exchange rate adjustment. But, its enforcement powers proved too limited, and the fixed exchange rate system established at Bretton Woods also failed.

- Experience has shown that a successful exchange rate control system requires continuing international cooperation. There must be agreement on the appropriate levels of exchange rates and on an acceptable rate of world inflation.

- Professor McKinnon's proposal does not guarantee a consensus on either of these issues. However, his system has the advantage of requiring participation by only three key countries—Germany, Japan and the United States.

World economic stability needs cooperation

Instability in world economic and financial performance has been conspicuous since the 1971 widespread adoption of floating exchange rates. Despite disagreement regarding the precise causes of this increased volatility, economists have offered several proposals to restore a higher degree of international economic stability. This article examines one such plan and compares it with previous programs that failed to achieve the desired stability.

Western world leaders recognized at the Williamsburg economic summit conference last year that closer coordination of international monetary policies was desirable to accelerate recovery from the world-wide recession and to promote economic stability among the industrialized countries of the West. Monetary history of the past 40 years may be regarded as an unsuccessful attempt to achieve just that goal.

The introduction of floating exchange rates in 1971 was formal recognition by the leading financial powers of their failure to devise an effective system of monetary coordination. Under floating exchange rates, a nation may follow any monetary policy as long as its exchange rate is allowed to adjust to market forces.

Coordinating Rates

Professor Ronald McKinnon of Stanford University recently proposed a new monetary rule to guide the growth of the U.S. money supply. If also adopted by other major economies, the rule would achieve effective control over the world money supply.

McKinnon suggested that the rate of growth of the U.S. money supply be governed by changes in foreign demand for dollars. When the demand for dollars is strong relative to the supply, with consequent dollar appreciation in the foreign-exchange market, he would have the Federal Reserve increase the money supply's rate of growth in order to stabilize the exchange rate of the dollar around some previously established rate. Conversely, if the dollar depreciated in foreign-exchange markets the Federal Reserve would decrease the money supply's rate of growth.

This monetary rule would result in greater stability in exchange rates and the rate of growth of the world money supply. However, variability in national money supplies would increase. This suggested rule is directly opposed to that championed by Milton Friedman who would have the domestic money supply increase at a steady rate that would not be altered by cyclical fluctuations in economic activity or exchange-rate movements.

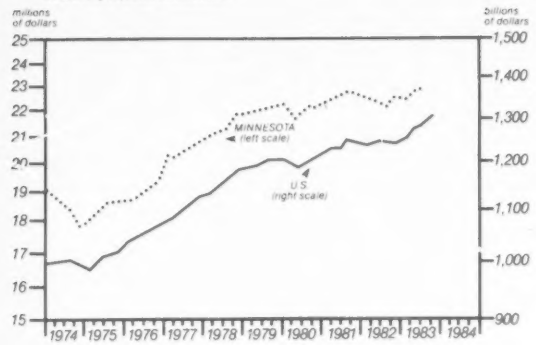
McKinnon believes that volatility in the dollar's exchange rate is a major factor aggravating business fluctuations here and abroad. For example, he argues that the current Federal Reserve policy of monetary restraint has resulted in an appreciation of the dollar that has prolonged the recession by raising the price of our exports abroad and lowering the price of imports. At the same time, the Fed's restrictive policies have kept U.S. interest rates high. This has attracted financial capital from western Europe and has frustrated attempts by European monetary authorities to stimulate their own economic recoveries.

An evaluation of McKinnon's proposal requires comparison with earlier monetary systems to see whether it removes any of the deficiencies that led to their downfall.

REGIONAL ECONOMIC CONDITIONS

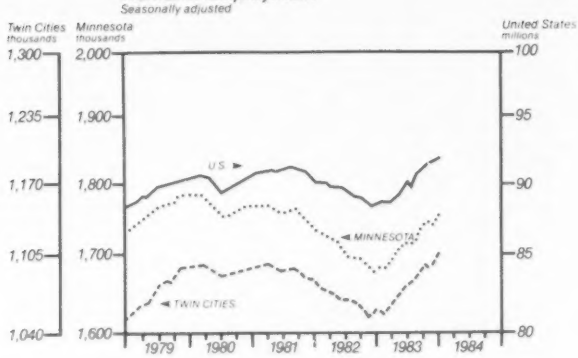
Real Personal Income

Seasonally adjusted annual rates



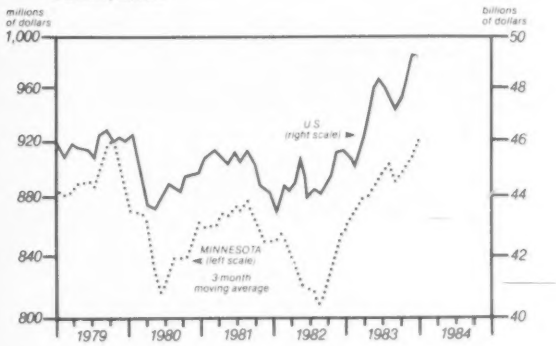
Nonfarm Employment

Seasonally adjusted



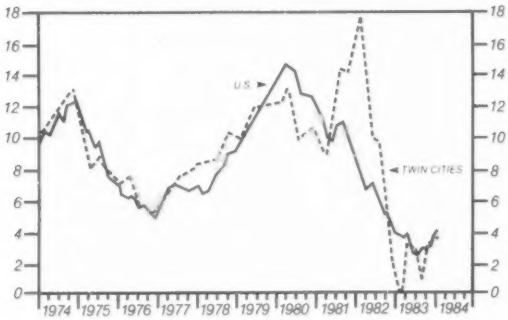
Real Retail Sales

Seasonally adjusted



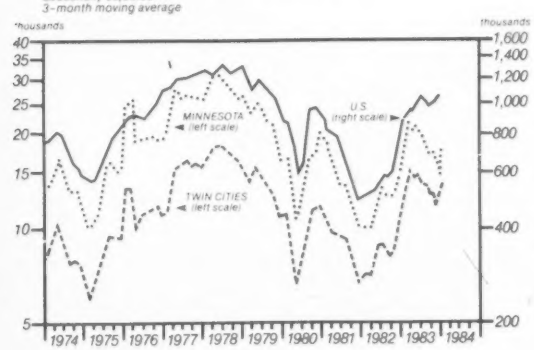
Consumer Price Index

Percent change from a year ago



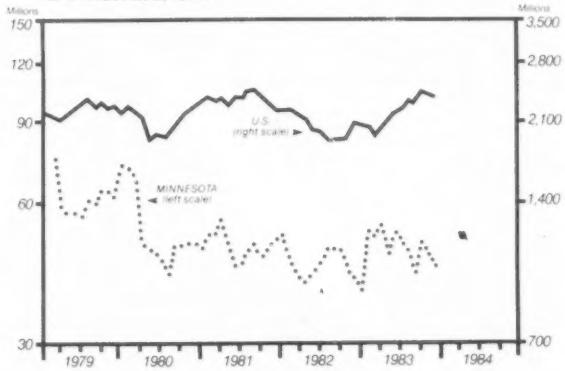
Housing Units Authorized

Building permits issued for 1–4 family units
Seasonally adjusted
3-month moving average



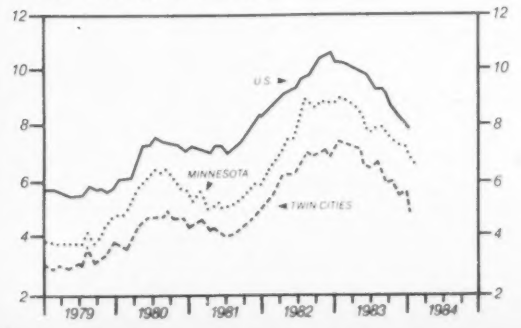
Total Private Nonresidential Construction

Building Permits Issued
Real 1977 Dollars, Seasonally Adjusted



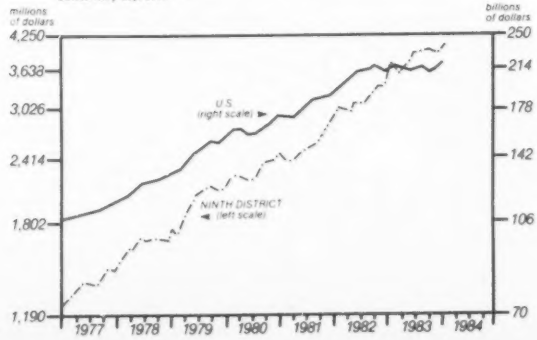
Unemployment Rates

Seasonally adjusted percent of labor force



Commercial and Industrial Loans

Outstanding at large commercial bank
Seasonally adjusted



The Gold Standard

Under the gold standard, each central bank established a buying and a selling price for gold. This, in effect, established a system of fixed exchange rates. The monetary rule imposed by the gold standard was that whenever a nation fell into a balance-of-payments deficit position, and thus experienced a loss of foreign-exchange reserves, the monetary authorities would allow a contraction of the money supply. This led to lower domestic prices and higher interest rates, discouraging imports and encouraging exports and financial-capital inflows. All of this was automatic and, in theory at least, did not require central-bank intervention.

Conversely, the country with a surplus balance-of-payments experienced net inflows of foreign exchange, resulting in an increase in commercial bank reserves and consequent expansion of the money supply. This led to higher prices and lower interest rates, which discouraged exports and encouraged imports and financial capital outflows.

The net effect of any balance-of-payments disturbance was to increase the money supply in the surplus country and reduce the money supply in the deficit country. Thus, little if any change occurred in the overall world money supply.

The system failed, however, when the surplus countries refused to obey the "rules of the game." Central banks refused to inflate in response to the influx of foreign exchange. Consequently, the entire burden of adjustment fell on the deflationary policies of the deficit country. These countries eventually refused to accept this and, one by one, countries departed from the gold standard. In the 1930s, this process deteriorated into a series of competitive devaluations as each country unsuccessfully attempted to shift the burden of balance-of-payments adjustment onto its neighbors.

Bretton Woods System

The Bretton Woods system, created after World War II, attempted to correct the deflationary bias of the gold standard. Like the gold standard, it required countries to declare fixed exchange rates. However, it forced the surplus countries to lend to the deficit countries, easing the burden of adjustment on the latter and allowing them to extend the adjustment process over a number of years. Additionally, it allowed countries to change their currency values if their balance-of-payments difficulties were due to long-term structural causes as opposed to short-term, self-correcting cyclical factors. This was done to avoid the adverse effects of competitive devaluations.

Under the Bretton Woods agreement, administered by the International Monetary Fund (IMF), there was no automatic adjustment mechanism to control the world's money supply. In practice, IMF members had to adjust their economic policies relative to the rate of inflation in the United States, the most important trading nation in the postwar period. If a country inflated faster, it would eventually have to slow its rate of monetary growth or devalue its currency. If it inflated slower, it was required to speed monetary growth or appreciate its currency.

The system worked well as long as the United States had what other major trading countries regarded as an acceptable inflation rate. When inflation in the United States began to accelerate in 1967, however, western European countries and Japan expressed a growing unwillingness to allow their price levels to follow. Germany and Japan, in particular, refused either to inflate or appreciate their currencies. As a consequence they began to run up large balance-of-payments surpluses with the United States.

The IMF found itself pushing on a string. It could refuse to allow countries to depreciate or appreciate their currencies, but it could not force them to do either. The Germans and Japanese, whose rates of inflation were below that of most countries, were primarily motivated by commercial considerations in their refusal to appreciate. Their position, however, was adopted by many other governments who felt the United States was exporting inflation.

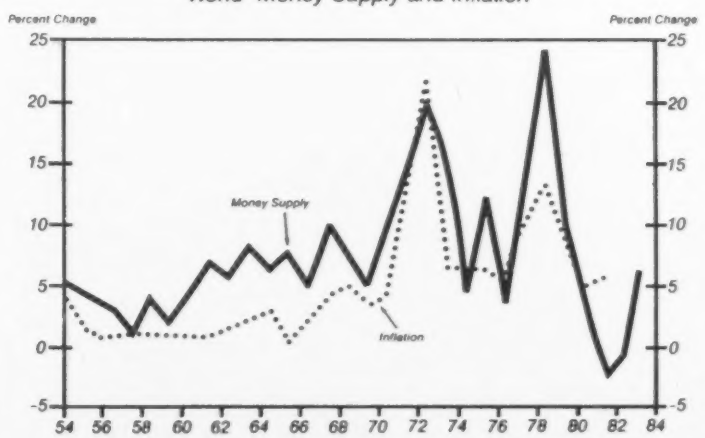
Under these circumstances, the United States was forced to devalue the dollar in 1971 and refused to undertake any new commitment to sustain a fixed dollar exchange rate. This marked the end of the Bretton Woods system and the beginning of the present era of floating exchange rates which, in theory, allows countries to follow independent monetary policies.

Rate Targets and Money Supply

Given this history, it is interesting to see McKinnon's present recommendations. Adopting his ideas, the Federal Reserve would announce that, henceforth, it would consider foreign as well as domestic demand for dollars in setting its short-term monetary-growth targets. When the dollar was particularly strong against foreign currencies, the money-supply growth target would be increased; when it was especially weak, the target would be reduced.

The effect would be to reduce the dollar's volatility in the foreign-exchange markets at the expense of more erratic domestic money-supply growth. However, the sum of all countries' money supplies would grow along a smoother path than in the past (see chart). In effect, the Fed would be expanding and contracting the domestic money supply to offset contractions and expansions abroad, thus stabilizing the world money supply.

"World" Money Supply and Inflation



"World" Money Supply: Sum of the money supply for 10 countries, denominated in U.S. dollars.
"World" Inflation: Weighted sum of industrial prices for 10 countries, lagged 2 years.

With the present strong dollar, McKinnon's theory implies that the Fed should announce a substantial increase in its short-term monetary growth targets. Federal Reserve response to the criticism that this might reawaken fears of inflation would be that this higher rate of monetary growth is designed to make up for the shortfall in the growth rate over the past three years.

Eventually, however, the rate of domestic monetary growth would be expected to slow to a steady rate designed to achieve zero inflation in a specified market basket of internationally traded manufactured goods and primary commodities. This is reminiscent of Irving Fisher's commodity standard proposal of a half century ago.

A policy today to increase the rate of growth of the U.S. money supply and depreciate the dollar would probably find wide support in diverse political quarters. In the longer run, however, this policy would require stringent control of the federal deficit.

While McKinnon believes that unilateral adoption of his policy by this country would provide short-term advantages, he recognizes that its long-run success requires international cooperation. It is unrealistic to expect U.S. monetary policy to be reduced merely to the role of offsetting independent monetary-policy initiatives abroad.

McKinnon believes that if at least Germany, Japan and the United States adopt his plan it will achieve most of its objectives. This limited-participation requirement is a great advantage over previous monetary-control systems. However, agreement is needed on two points to achieve the desired cooperation: There must be consensus on the exchange-rate ranges that are to trigger monetary-policy actions, and agreement must be reached on the definition of an acceptable rate of world inflation.

Both of these requirements are fundamental and reasonable, but it should be remembered that the Bretton Woods system collapsed precisely because the same three countries could not agree on them.

McKinnon also argues that it is the country whose currency is unduly strong—the country with a balance-of-payments surplus—that should take the lead. However, the gold standard floundered precisely because the strong currency nations would not do so. Finally, the system would restrict the size of fiscal deficits that countries could incur. Unfortunately, except under conditions of extreme economic crisis, no country has ever been willing to surrender its fiscal sovereignty and make an international commitment to control deficits.

Thus, the weakest link in McKinnon's proposal is that its success depends entirely on the willingness and ability of central banks to abide by the "rules of the game." Long experience has shown that central banks will not always do this if the cost is further aggravation of other economic problems, and IMF attempts to deal with offending countries have not always been effective.

Morever, if countries could agree to McKinnon's two fundamental conditions, both the gold standard and the Bretton Woods system would be equally feasible and, in some respects, superior to his proposal—the gold standard because it functions automatically and the Bretton Woods system because it provides a framework for surveillance and enforcement as well as allowing for some flexibility in dealing with difficult cases. McKinnon's program seems to have none of these advantages.

Conclusion

There is widespread dissatisfaction with the current system of floating exchange rates. It has eliminated neither the large U.S. balance-of-payments deficits nor world inflation. Increased national independence regarding domestic monetary policies has not produced greater economic stability or higher levels of employment. Exchange rates have fluctuated wildly. It is no wonder that considerable nostalgia exists for a return to less-flexible exchange rates. Indeed, this policy was suggested in guarded terms at the Williamsburg Summit.

A move toward more stable exchange rates is a necessary first step toward greater control over the world's money supply. No one believes, however, that this is immediately attainable, mainly because the necessary conditions mentioned in connection with McKinnon's proposal remain unfulfilled.

A return to some form of the Bretton Woods system would likely provide a better framework for creating a new international monetary order than any of the alternatives thus far proposed, including McKinnon's. Elements of his proposal, however, could prove useful in achieving this new order. By requiring only a tripartite agreement and by allowing exchange-rate adjustment within an acceptably broad range, it may provide sufficient flexibility to make a viable beginning in the development of a badly needed system of world monetary-policy coordination.

The international monetary system has flirted with crisis more than once in recent years. Can we afford to trust fate much longer?

Indicators is a publication of the Economics Department of Norwest Bank Minneapolis, N.A. For further information, contact Dr. Sung Won Sohn, Senior Vice President and Chief Economist, (612) 372-7871; Dr. Richard Smith, Vice President, Director of International Economics, (612) 372-5845; Dr. Larry J. Wipf, Vice President, Director of Regional Economics, (612) 372-9281; or Janet Grant, Communications Officer, Corporate Communications, (612) 372-6704.

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NORWEST CORPORATION

ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT - DR. SUNG WON SOHN, CHIEF ECONOMIST May 10, 1984

Highlights

- Many farm communities have not shared in the national economic rebound. Northern Minnesota and Wisconsin are just beginning to head upward. Contrasting sharply with this, the Twin Cities economy is roaring ahead.
- Farmers with moderate debt loads remain healthy. Highly leveraged operators, however, have received little relief from today's favorable commodity prices; they are likely to experience difficult and perhaps worsening financial problems as farm earnings fail to keep up with expenses and debt-service requirements.
- Land prices have weakened decidedly since the beginning of 1984, as more land has come on the market and as farmers anticipate lower crop prices this fall. Although land values are likely to remain under pressure, much of the downward correction may already be taking place.
- After several years of weakness, farm-loan demand is on the upswing at agricultural banks. This reflects cutbacks in loans provided by other lenders as well as increased operating capital needs associated with the rebound in crop acreage this spring. Weak capital spending, however, will retard agricultural loan growth.
- Employment in the Twin Cities is now 1 percent higher than the peak reached before the 1981-82 recession. Local bankers look for continued strong expansion in consumer and business spending. Loan demand has rebounded sharply; heavy loan demand will continue for the balance of the year.
- Continued weakness in loan demand and repayment rates characterize credit conditions in northern Minnesota-Wisconsin. With the exception of Iron Range communities, bankers look for improving loan demand during the next six months.

Spring 1984 Regional Economic Survey

Despite some bright spots, the regional economy has not rebounded as rapidly as the national economy. Regional employment remains well below pre-recession levels. Although commodity prices have improved significantly, a pessimistic mood has settled over many communities as more farm auction notices are posted. This will continue to dampen economic activity in many rural areas across the region.

In sharp contrast to this, Twin Cities bankers continue to be very optimistic as the local economy shifts from economic recovery to genuine expansion. Meanwhile, many northeastern Minnesota communities anticipate gradually improving economic conditions during the balance of 1984.

This picture emerges from the results of Norwest's 16th-semi-annual survey of the region's bankers. The survey, conducted in early April, drew responses from more than 600 bankers in Iowa, Minnesota, Montana, Nebraska, North Dakota, South Dakota and Wisconsin.

Economic Conditions

Agricultural Communities

Farm Earnings Improve. Livestock prices are one of the bright spots this year. Following heavy losses in 1983, hog and beef production has turned profitable, reflecting production cutbacks and improving consumer demand. Declining milk-price supports, however, have made dairy operations less profitable.

Current levels of corn and soybean prices are also considered favorable. Although lower prices are anticipated, farmers who contract ahead with elevators or sell in the future markets should be able to lock in decent prices for their 1984 production. The wheat outlook is less certain, but the government program offers price protection.

Strong Farm Program Sign-Up. In the major corn-producing areas of the region covered by this survey, two-thirds of the corn acreage is enrolled in the government program. More than 70 percent of the region's wheat base was enrolled in the 1984 government program. Participation in the revised wheat program should be even higher. These figures for both wheat and corn exceed the national average.

High leverage problem. The financial condition of farmers and ranchers varies greatly throughout the region, depending on debt loads and, to some extent, management practices. While farmers with low debt loads remain healthy, improved commodity prices have not brought relief to highly leveraged operators.

The consensus was that highly leveraged customers are in worse financial shape today than a year ago. Nearly 30 percent of the bankers felt their heavily indebted farmers were in much worse financial shape than a year ago; few bankers reported any improvement for these customers.

These producers need favorable prices just to stay even. The highly leveraged operators are likely to continue to experience difficult and perhaps worsening financial problems as farm earnings fail to keep up with expenses and debt-service requirements. The shake-out of these operators could extend over the next couple of years. While these producers are in the minority, their financial stress has prompted many financially strong producers to adopt a cautious attitude.

Some bankers question whether government officials realize how bad economic conditions really are. Despite

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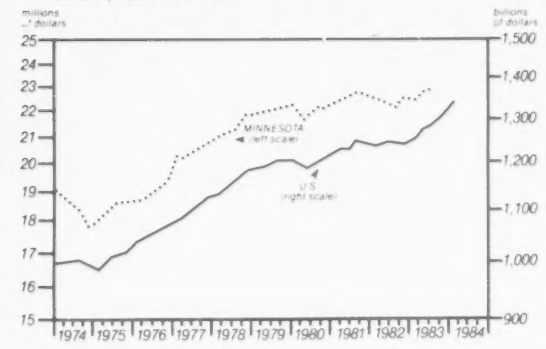
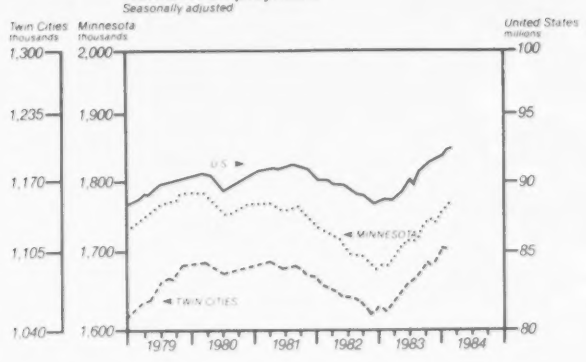
REGIONAL ECONOMIC CONDITIONS

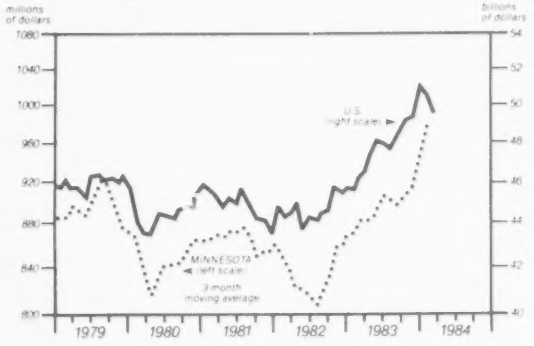
Real Personal Income
Seasonally adjusted annual rates


millions of dollars
billions of dollars
MINNESOTA (left scale)
U.S. (right scale)
1974 1975 1976 1977 1978 1979 1980 1981 1982 1983 1984

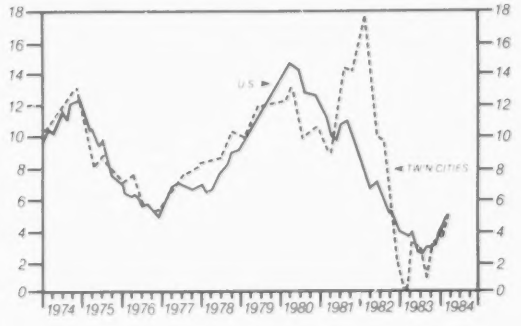
Nonfarm Employment
Seasonally adjusted



Real Retail Sales
Seasonally adjusted



Consumer Price Index
Percent change from a year ago



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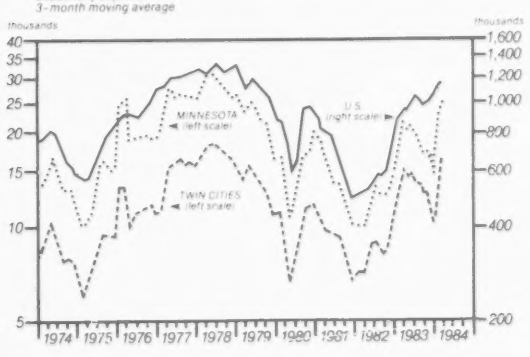
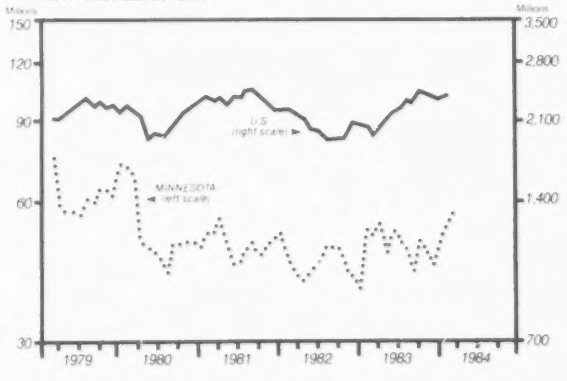
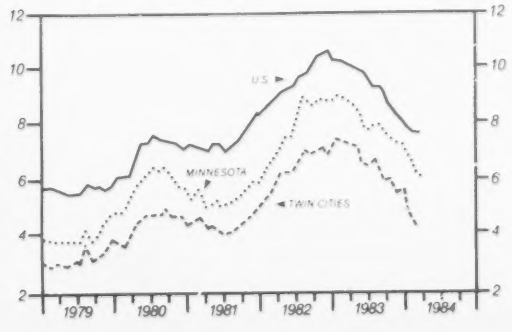
Building permits issued for 1–4 family units
Seasonally adjusted
3-month moving average



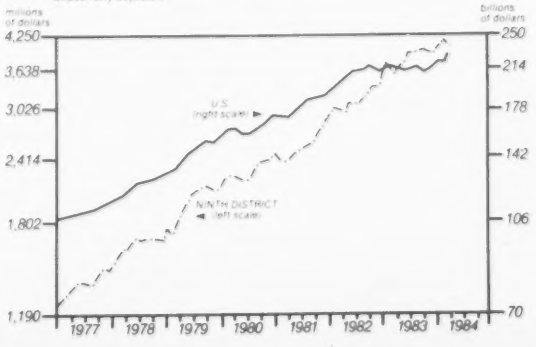
Total Private Nonresidential Construction
Building Permits Issued
Real 1977 Dollars, Seasonally Adjusted



Unemployment Rates
Seasonally adjusted percent of labor force



Commercial and Industrial Loans
Outstanding at large commercial bank
Seasonally adjusted


millions of dollars
billions of dollars
U.S. (right scale)
NINTH DISTRICT (left scale)
1977 1978 1979 1980 1981 1982 1983 1984

Spring 1984 Regional Economic Survey

Conducted by:
Norwest Bank Des Moines, N.A.
Norwest Bank Minneapolis, N.A.
Norwest Bank Omaha, N.A.

Credit Conditions

Unless otherwise indicated, data show percent of bankers falling in each of the categories - higher, same, lower, etc. Items may not add up to 100 percent due to rounding.

1. *What is your current* ***loan-to-deposit*** *ratio?*

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	58.6%	50.0%	60.0%	68.0%
Minnesota	61.1	53.0	62.0	70.0
North Dakota	52.2	45.0	51.0	72.0
South Dakota	55.0	46.0	56.0	64.0
Montana	59.2	50.0	58.0	71.3
Wisconsin	66.2	60.3	65.0	73.5
Iowa	55.2	45.3	55.0	62.8
Nebraska	62.9	54.3	64.5	71.0
Twin Cities Banks	64.5	56.8	63.0	72.0
N. Minn.-Wisc.	59.7	51.5	61.5	69.8

2. ***Loan-to-deposit ratio*** *higher or lower than desired?*

	Higher	Desired	Lower
All Ag Banks	14%	40%	46%
Minnesota	15	43	42
North Dakota	4	32	63
South Dakota	10	50	40
Montana	17	31	53
Wisconsin	20	25	55
Iowa	14	32	55
Nebraska	24	46	30
Twin Cities Banks	15	34	51
N. Minn.-Wisc.	16	31	53

3. ***Typical interest rate*** *charged for operating loans?*

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	14.1%	13.8%	14.0%	14.5%
Minnesota	14.0	13.8	14.0	14.5
North Dakota	14.0	13.8	14.0	15.0
South Dakota	14.2	14.0	14.0	14.5
Montana	14.1	13.8	14.0	14.5
Wisconsin	13.7	13.0	13.8	14.0
Iowa	14.2	14.0	14.3	14.5
Nebraska	14.0	13.6	14.0	14.4
Twin Cities Banks	13.7	13.1	13.5	14.0
N. Minn.-Wisc.	14.0	13.5	14.0	14.5

4. *Percentage change in* ***loan volume*** *during past 12 months?*

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	4.9%	0.0%	4.0%	10.0%
Minnesota	5.5	0.0	5.0	10.0
North Dakota	4.2	0.0	2.0	14.0
South Dakota	2.8	-2.0	0.0	10.0
Montana	6.6	0.0	5.0	10.0
Wisconsin	4.9	0.0	5.0	9.5
Iowa	4.7	0.0	1.0	10.0
Nebraska	5.4	0.0	5.0	10.9
Twin Cities Banks	13.0	5.0	12.0	20.0
N. Minn.-Wisc.	5.1	0.0	2.0	12.5

5. *Are customers* ***repaying loans*** *at a faster or slower rate?*

	Faster	Same	Slower
All Ag Banks	5%	53%	42%
Minnesota	5	62	33
North Dakota	4	61	35
South Dakota	3	50	47
Montana	11	56	33
Wisconsin	5	90	5
Iowa	6	28	66
Nebraska	5	41	54
Twin Cities Banks	15	83	2
N. Minn.-Wisc.	9	72	19

6. *Did your bank* ***sell participations*** *to PCAs in past 3 months?*

	Yes	No
All Ag Banks	3%	96%
Minnesota	5	94
North Dakota	6	94
South Dakota	2	98
Montana	0	100
Wisconsin	0	100
Iowa	2	98
Nebraska	3	97

7a. *Change expected in* ***agricultural loan volume*** *during* ***next 12 months****?*

	Higher	Same	Lower
All Ag Banks	57%	37%	6%
Minnesota	57	38	4
North Dakota	59	35	6
South Dakota	51	44	5
Montana	42	47	11
Wisconsin	40	55	5
Iowa	63	30	8
Nebraska	67	26	7

7b. *Change expected in* ***commercial and industrial loan volume*** *in next 6 months?*

	Higher	Same	Lower
Twin Cities	73%	27%	0%
N. Minn.-Wisc.	42	48	10

7c. *Change expected in* ***total loan volume****?*

	Higher	Same	Lower
All Ag Banks	54%	40%	6%
Minnesota	59	35	5
North Dakota	52	38	10
South Dakota	36	61	3
Montana	50	47	3
Wisconsin	65	30	5
Iowa	56	40	5
Nebraska	55	40	5
Twin Cities Banks	83	18	0
N. Minn.-Wisc.	47	44	9

8. Anticipated trend in **loan-to-deposit ratio** during **next 12 months**?

	Higher	Same	Lower
All Ag Banks	59%	34%	8%
Minnesota	59	33	8
North Dakota	60	31	9
South Dakota	57	35	8
Montana	53	44	3
Wisconsin	40	55	5
Iowa	56	36	8
Nebraska	67	25	8
Twin Cities Banks	88	7	5
N. Minn.-Wisc.	47	34	19

9. Percentage increase in **bank deposits** during past 12 months?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	6.5%	3.0%	6.5%	10.0%
Minnesota	6.8	3.6	7.3	10.0
North Dakota	5.9	3.5	6.5	10.0
South Dakota	5.7	1.2	6.0	10.0
Montana	7.9	3.0	6.8	10.0
Wisconsin	7.4	5.0	8.0	10.0
Iowa	6.5	3.0	6.0	10.0
Nebraska	5.6	3.0	6.0	10.0
Twin Cities Banks	16.3	10.0	15.0	20.0
N. Minn.-Wisc.	6.2	0.0	6.4	10.0

10. **Anticipated deposit growth** during **next** 12 months?

	Stronger	Average	Weaker
All Ag Banks	18%	62%	19%
Minnesota	18	61	21
North Dakota	15	61	23
South Dakota	14	65	21
Montana	17	72	11
Wisconsin	30	55	15
Iowa	18	66	16
Nebraska	21	59	20
Twin Cities Banks	22	59	20
N. Minn.-Wisc.	22	66	13

Business Conditions

11. Is **farm/ranch income** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	20%	40%	40%
Minnesota	22	42	35
North Dakota	18	44	37
South Dakota	29	38	33
Montana	11	58	31
Wisconsin	0	30	70
Iowa	24	31	45
Nebraska	13	38	49

12. Change in **farm income** during **next 12 months**?

	Higher	Same	Lower
All Ag Banks	20%	50%	29%
Minnesota	18	47	35
North Dakota	14	62	23
South Dakota	31	40	29
Montana	17	69	14
Wisconsin	0	30	70
Iowa	28	48	24
Nebraska	22	54	24

13a. Percentage change in **cropland prices** from a year ago?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	-12.1%	-20.0%	-10.0%	-5.0%
Minnesota	-12.3	-20.0	-10.0	-7.3
North Dakota	-9.4	-15.0	-10.0	-5.0
South Dakota	-11.8	-20.0	-10.0	-5.0
Montana	-3.6	-10.0	0.0	0.0
Wisconsin	-6.9	-10.0	-5.0	0.0
Iowa	-16.4	-20.0	-15.0	-10.0
Nebraska	-14.8	-20.0	-15.0	-10.0

13b. Percentage change in **pastureland prices** from a year ago?

	Survey Average	Response by Percentile 25th	50th	75th
All Ag Banks	-12.0%	-20.0%	-10.0%	0.0%
Minnesota	-10.0	-20.0	-10.0	0.0
North Dakota	-8.8	-15.0	-10.0	-10.0
South Dakota	-13.6	-20.0	-13.0	-5.0
Montana	-4.1	-10.0	0.0	0.0
Wisconsin	-7.4	-10.0	-7.5	0.0
Iowa	-17.3	-25.0	-20.0	-10.0
Nebraska	-16.9	-25.0	-15.0	-10.0

14. Anticipated trend in **land prices** during **next 12 months**?

	Increase	Stable	Decrease
All Ag Banks	3%	45%	52%
Minnesota	2	48	50
North Dakota	3	46	49
South Dakota	2	37	61
Montana	6	67	28
Wisconsin	0	47	53
Iowa	3	40	56
Nebraska	5	39	55

15. Are **capital expenditures** higher or lower than a year ago?

	Higher	Same	Lower
All Ag Banks	5%	23%	71%
Minnesota	11	26	63
North Dakota	4	24	72
South Dakota	0	31	69
Montana	6	33	61
Wisconsin	0	40	60
Iowa	1	10	89
Nebraska	0	18	82
Twin Cities Banks	51	41	7
N. Minn.-Wisc.	19	63	19

16. Change expected in **capital outlays** during **next 12 months**?

	Stronger	Same	Lower
All Ag Banks	5%	38%	56%
Minnesota	9	39	51
North Dakota	6	35	59
South Dakota	2	35	62
Montana	3	54	43
Wisconsin	0	30	70
Iowa	3	39	57
Nebraska	1	36	63
Twin Cities Banks	54	39	7
N. Minn.-Wisc.	31	53	63

17. Are **retail sales** better or worse than a year ago?

	Better	Same	Worse
All Ag Banks	20%	43%	35%
Minnesota	24	46	29
North Dakota	13	43	44
South Dakota	19	46	33
Montana	22	53	25
Wisconsin	35	45	20
Iowa	20	44	35
Nebraska	13	33	54
Twin Cities Banks	76	24	0
N. Minn.-Wisc.	47	38	16

18. Are **automobile sales** better or worse than a year ago?

	Better	Same	Worse
Twin Cities Banks	95%	10%	0%
N. Minn.-Wisc.	81	13	3

19. Change expected in **consumer spending** during **next six months**?

	Stronger	Same	Weaker
Twin Cities Banks	83%	15%	2%
N. Minn.-Wisc.	53	41	6

20. Are **housing starts** better or worse than a year ago?

	Better	Same	Worse
Twin Cities Banks	78%	17%	5%
N. Minn.-Wisc.	22	56	22

21. Anticipated trend in **economic conditions** during **next six months**?

	Better	Same	Worse
All Ag Banks	19%	49%	30%
Minnesota	22	52	26
North Dakota	24	39	37
South Dakota	16	52	31
Montana	31	44	25
Wisconsin	30	40	30
Iowa	13	52	35
Nebraska	12	58	30
Twin Cities Banks	80	20	0
N. Minn.-Wisc.	44	47	9

22a. Financial condition of **highly leveraged** farm customers compared with a year ago?

	Much Better	Slightly Better	About Same	Slightly Worse	Much Worse
All Ag Banks	0%	8%	15%	47%	29%
Minnesota	0	12	19	50	19
North Dakota	0	7	11	58	24
South Dakota	0	11	16	50	21
Montana	0	12	18	50	21
Wisconsin	0	0	25	50	25
Iowa	0	1	8	35	56
Nebraska	0	3	9	45	43

22b. Financial condition of **top 20 percent of farm customers** (by gross sales) compared with a year ago?

	Much Better	Slightly Better	About Same	Slightly Worse	Much Worse
All Ag Banks	3%	38%	38%	18%	1%
Minnesota	5	42	34	18	1
North Dakota	0	30	44	25	1
South Dakota	10	37	38	14	0
Montana	3	36	50	11	0
Wisconsin	0	15	50	30	5
Iowa	2	44	33	17	3
Nebraska	0	43	41	16	0

23a. How does the overall **quality** of your **farm loan portfolio** compare with a year ago?

	Increased	Same	Decreased
All Ag Banks	7%	40%	52%
Minnesota	7	51	43
North Dakota	6	39	55
South Dakota	8	37	53
Montana	14	39	47
Wisconsin	0	45	55
Iowa	1	34	65
Nebraska	12	27	61

23b. **Anticipated change** in overall quality of your **farm loan portfolio** during next 12 months?

	Increase	Same	Decrease
All Ag Banks	23%	45%	31%
Minnesota	25	48	26
North Dakota	24	39	37
South Dakota	27	35	37
Montana	31	50	19
Wisconsin	10	30	60
Iowa	22	47	32
Nebraska	19	52	29

Bankers' Comments

Economic Prospects for 1984

Iowa - *"With good livestock prices and heavy enrollment in the government program, we are optimistic about agriculture in 1984."*

"Most borrowers in about same situation as a year ago. Those with cash grain, hogs or cattle to sell in 1984 should have improved income."

". . . Some large farmers with heavy debt will have to sell land or equipment and restructure their operation."

"(Expect) some slight improvement due to stronger prices. The highly leveraged farmer will still not be able to survive, which will cause a large amount of ground to be sold which will keep land values from rising."

"There are opportunities to lock in a profit on corn, beans and livestock with the present market. Those in the (government) program are protected."

Minnesota - *"We are going to lose a number of farmers and small businesses in our area because they can't service the debt they already have."*

"Farmers who are not highly leveraged should have an acceptable or good year. Expect a few more smaller farmers to quit after this year."

"Highly leveraged operators will continue to have a difficult, perhaps worsening, situation."

"Farmers believe crop prices will be down in 1984. This has an important psychological impact on our community."

"We are not seeing any economic recovery in this bank trade area."

Montana - *"If drought conditions continue, the number of foreclosures and business close outs could start ballooning."*

"If we get adequate moisture, we will have a good year."

"Stable (outlook), still in a slow start situation compared to the rest of the country."

"Expect nonfarm sector improvement with improved building and lumber industry. Tourism improvement will also provide positive benefit."

Nebraska - *"Expect prices to be fairly good, so farmers not highly leveraged should be okay. Those who are highly leveraged will have a very difficult time."*

"The highly leveraged farmers in our area are struggling due to high interest costs. The stable, well fixed farmers are going to show moderate to strong gains."

". . . Will probably lose about 5 percent of the farmers by next year in our area who are highly leveraged usually due to large capital expenditures in the late '70s and early '80s."

". . . encouraging livestock prices and price protection from the government program lend optimism."

North Dakota - *"The average farm outlook is tight, however, the good operator will come out okay."*

"(1984) will be better. On the upswing!"

"Soybean and feedgrain prices look good for '84 crop if priced right. Wheat outlook uncertain."

"Very slow for the ag sector, however, oil industry looks like it is beginning to pick up again."

"Liquidations will increase considerably over the next two years as highly leveraged operators find they cannot service debt."

South Dakota - *"Financially strong ag customers will continue to be extremely cautious in purchasing equipment or real estate. Commodity prices need to remain near current levels in order for leveraged operators to cash flow operations, reduce debt, and have a positive return on equity."*

"South Dakota has a dual economy. Large cities are going strong—good employment, retail sales etc. Rural economy and small towns are not good—sales way down, small businesses in trouble."

"Overall, livestock looks good in 1984. Continuing pressure on land prices—quite a bit has to trade hands."

"Slight improvement in cattle prices has improved the position of most of our borrowers."

Wisconsin - *"Dairy income down somewhat from previous years."*

"The nonfarm segment and employment will improve. Our predominantly dairy, agricultural economy looks stagnant. Most are trying to ride out the economic storm."

Twin Cities - *"Excellent outlook - we are looking forward to heavy loan demand and strong economic activity."*

"Optimistic with concern over deficits and interest rate changes which might stall the economy."

"Very optimistic."

Northern Minnesota/Wisconsin - *"Overall trend should be up."*

"Expect very little change."

"If interest rates do not rise, economic outlook will be better."

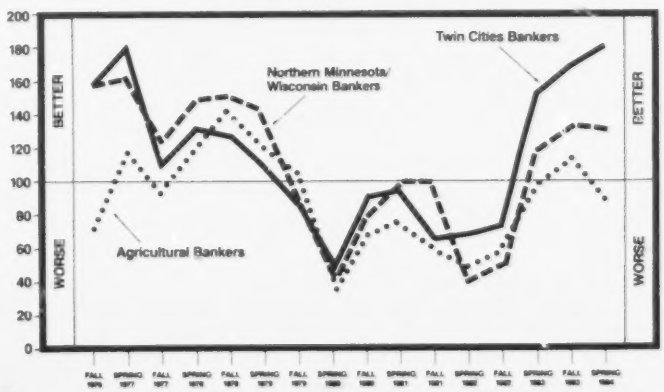
Iron Range - *"(Outlook) slightly better than 1983."*

"Very little improvement over 1983."

"Still in for some tough times."

UPPER MIDWEST CONFIDENCE INDEX

Composite index of current conditions and bankers' appraisal of economic prospects during the next six months



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this pessimism, bankers also report that they are quite optimistic about the prospects for good farm managers and those with moderate debt loads. About 40 percent of the bankers said the top 20 percent of their farm customers (in terms of gross sales) were in slightly better financial shape today than a year ago. Half that number felt these larger farmers were in slightly worse shape.

Land Values Down Sharply. One of the major problems in agriculture today is the decline in asset values. Land prices have weakened decidedly in the last few months as more land has come on the market and as farmers anticipate lower corn and soybean prices this fall.

According to the region's bankers, cropland and pastureland prices are down an average of 12 percent from a year ago, but considerable variation was reported. One-fourth of the bankers estimated that cropland prices declined 20 percent or more, while another one-fourth of the bankers reported declines of 5 percent or less. Within the region, Montana and Wisconsin bankers reported the smallest fluctuations in land values during the past 12 months, while Iowa and Nebraska reported greater than average declines.

Land prices are expected to remain under pressure. Half of the bankers forecast declining land values during the next 12 months; few anticipate rising land prices. However, since the prospect of weaker crop prices is already being factored into land values, much of the downward correction in land prices may already be taking place.

Ag Communities Still Lagging. Many rural communities have not shared in the national economic rebound. Farmers continue to pare capital outlays. General retail sales also remain sluggish. Half of the bankers expect little change in overall economic conditions during the next six months. Another 30 percent of the bankers anticipate a weaker economic environment. Many express concern about future economic prospects if crop prices decline later this year as is widely forecast. Yet hedging opportunities and government program participation are expected to soften the blow. Nevertheless, highly leveraged farmers will continue to struggle to survive.

Twin Cities

Roaring Ahead. After staging a strong recovery during 1983, the Twin Cities economy began a new expansion phase early this year. Bankers look for an excellent year. They report that auto sales, general retail sales and housing starts are all up sharply from recession levels. Capital spending is also on the rise.

By March 1984, Twin Cities nonfarm employment was 1 percent higher than the peak reached before the 1981-82 recession. The recovery has been widespread, with the largest employment gains occurring in business services and the manufacture of building materials, computers and transportation equipment.

This strong economic performance matches the national rebound, but contrasts sharply with the weaker economic environment in many rural communities in the state. So far, the rest of Minnesota has regained only half of the jobs lost during the last recession. This, in part, reflects the more serious recession experienced by many communities outside of the Twin Cities.

Most Twin Cities bankers were very optimistic about the prospects for the balance of the year. They forecast continued growth in both consumer and business spending. But some bankers expressed concern that the federal government deficit would boost interest rates and stall the economy in 1985.

Northern Minnesota/ Wisconsin

Recovery Just Beginning. Some signs of an economic recovery are evident. Although housing activity and capital spending remain in the doldrums, auto sales and, to some extent, general-retail sales are better than a year ago. However, wide variation is evident within this region as well.

Northern Wisconsin bankers were the most optimistic. Nearly all of them said economic conditions were better than a year ago. They foresee continued improvement in overall economic conditions, including both consumer and business spending.

Iron Range bankers look for slightly better economic conditions than in 1983. Taconite employment has increased, but remains far below pre-recession levels. Capital spending is expected to remain depressed, but overall consumer spending is projected to increase.

Bankers in other northern Minnesota communities also look for some improvement in economic activity during 1984. Bright spots include logging, wood-products manufacturing and the tourist industry; the farm economy was cited as a negative factor. Capital spending will continue to be restrained, while consumer spending should strengthen.

Credit Conditions

Agricultural Banks

Loan Demand Rising. Credit conditions at agricultural banks are characterized by slumping repayment rates, renewed loan demand growth, an upturn in the banks' share of all farm operating loans, and ample funds for lending to qualified borrowers.

Following several years of weakness, farm loan demand has turned upward. Total loan volume at country banks was up an average of 4.9 percent from a year ago, but considerable variation existed. Twenty-five percent of the banks reported no increase in loan demand, while another 25 percent had increases of 10 percent or more.

At 58.6 percent, the average loan-to-deposit ratio at agricultural banks was eight-tenths of 1 percentage point higher than a year ago, the first annual increase since 1980. One-fourth of the banks had ratios of 50 percent or less, while another one-fourth had a ratio of 68 percent or higher. Although 46 percent of the bankers still view their ratio as lower than desired, this is a more favorable appraisal than reported for the last couple of surveys.

The upswing in loan demand is projected to continue. Nearly 60 percent of the bankers—the highest reading since October 1980—expect agricultural loans to increase during the next 12 months, while only 6 percent anticipate a decline. This increased loan demand is expected to push loan-to-deposit ratios higher over the next 12 months.

The renewed growth in loan demand at most agricultural banks reflects increased operating capital needs associated with the rebound in crop acreage this spring as well as cutbacks in loans provided by other lenders. Weak demand for farm machinery and facilities loans, however, will retard agricultural loan growth at commercial banks.

Other Lenders Cutback. Among other lenders, the volume of nonreal estate farm loans held by Production Credit Association (PCAs) at the end of 1983 was down 6.8 percent nationwide from the previous year. At the end of 1983 PCAs were lending money to 7 percent fewer customers than a year earlier. The dollar volume of loans made in late 1983 was the lowest for that period since 1978.

Preliminary figures also show that nonreal estate loans held by the Farmers Home Administration declined slightly during 1983. In addition, the volume of Commodity Credit Corporation price-support loans is down sharply because of higher crop prices.

Farm-loan repayment rates declined again, after the modest rebound reported last October. Over 40 percent of the banks said customers were repaying loans at a slower rate than a year ago; only 5 percent reported faster loan-repayment rates.

Interest rates on farm operating loans averaged 14.1 percent in April, up a mere one-tenth of 1 percent since last fall. Rates charged by country banks have fluctuated less than the national prime rate.

Deposits at agricultural banks are up 6.5 percent from a year ago. One-fourth of the bankers reported growth of 3 percent or less, while another one-fourth experienced deposit growth of 10 percent or more. Deposit growth appears to have slowed in recent months, after spurting ahead following the introduction of new money-market accounts in late 1982. Bankers anticipate near normal deposit growth during the next 12 months.

Stress in the farm sector is reflected in the banks' loan performance. Half of the bankers said the overall quality of their farm-loan portfolios had declined from a year ago; only 7 percent reported improvement in loan quality. Forty-five percent of the bankers anticipate little change in the overall quality of their agricultural loan portfolios during the next 12 months. Of the remaining bankers, the proportion that expects declining loan quality slightly exceeds those that anticipate improved loan portfolios.

Twin Cities

Strong Loan Demand, Deposit Growth. Loan demand has rebounded sharply at Twin Cities banks. Total loans outstanding increased an average of 13 percent during the past 12 months. This compares with the sluggish 3.9 percent increase reported last October. One-fourth of the banks reported increases of 5 percent or less, while another one-fourth experienced loan growth of 20 percent or more. Reflecting stronger economic conditions, loan repayment rates continued to improve during the past six months.

Bankers also reported strong deposit growth, averaging 16.3 percent since April 1983. Deposits were up 10 percent or less at one-fourth of the banks, while they grew 20 percent or more at another one-fourth of the banks.

Despite this sharp rise in deposits, the average loan-to-deposit ratio increased 1.2 percentage points since last October to 64.5 percent. This is still 3.3 points below the peak reached two years ago. One-fourth of the banks had a ratio of 56.8 percent or less, while another one-fourth had a ratio of 72 percent or more. Half of the bankers viewed their ratio as lower than desired, down from two-thirds last October.

Interest rates on operating loans averaged 13.7 percent in early April at Twin Cities banks, up three-tenths of 1 percentage point from last fall.

Twin Cities bankers look for heavy loan demand during the next six months. None of the bankers anticipated weaker loan demand. Although deposit growth is expected to be about average, loan-to-deposit ratios are projected to rise during the balance of the year.

Northern Minnesota/ Wisconsin

Credit Weakness Persists. Sluggish deposit growth and continued weakness in both loan demand and repayment rates characterize current credit conditions. Loan volume is up an average of 5.1 percent from a year ago, but Iron Range bankers reported a small decline. Despite this weak overall pattern, one-fourth of the bankers in this region reported loan increases of 12.5 percent or more. Loan demand tended to be strongest in Northern Wisconsin.

Deposit growth averaged 6.2 percent during the past 12 months, down from last October's figure of 9.1 percent. Some bankers reported declines in deposits, while others experienced increases of 10 percent or more. Deposit growth was the weakest in Iron Range communities.

The average loan-to-deposit ratio slipped 1.1 percentage points during the past six months to 59.7 percent, the lowest level since October 1977. Many bankers considered their ratio as lower than desired. Twenty-five percent of the banks had a ratio of 51.5 percent or less, while another 25 percent had a ratio of 69.8 percent or more.

Interest rates charged for operating loans averaged 14 percent in April, unchanged from last October. Bankers are looking for moderate improvement in loan demand during the next six months. And loan-to-deposit ratios are projected to drift upward. Iron Range bankers anticipate the least improvement in loan demand. Business loan demand is expected to be flat, while slight increases in consumer loans are possible. Northern Wisconsin bankers were more optimistic in their appraisal of loan demand for the balance of this year.

by Dr. Larry J. Wipf
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NORWEST CORPORATION

ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT / DR. SUNG WON SOHN, CHIEF ECONOMIST JULY 13, 1984

Highlights

- Higher interest rates have increased the debt-service burden of the Latin American countries. Unfortunately, interest rates are expected to continue their upward trend. This will increase interest costs for the debtors and hurt exports to industrialized countries as well.

- A long period of economic contraction and the prospects for further hikes in interest rates are creating political and social problems in debtor countries. Recognizing the reality at home, Latin American nations likely will modify austerity measures and increase attention on job creation.

- Reflecting economic stimulation through deficit spending caused by domestic political considerations, the economies in the region should show economic growth in coming months. However, government deficits, inflation and deficit on the current account — the combination of trade and service balances — will continue to be problems.

- Argentina's decision to subordinate external considerations to domestic political concerns could be a catalyst for finding a long-term solution for the debt problem. The most likely scheme is to put upper and lower limits on interest rates on outstanding debt. This means that the cost of economic adjustments will be shared by both debtor nations and international banks.

Latin American Debt

Latin America is watching us for clues on interest rates. On the surface, economic conditions in this country seem made in heaven. Employment gains are strong, and the inflation picture continues to look favorable. A boom is nice, but a bust is generally not too far behind. The economy has to be throttled back to reduce speed.

But that may not be enough. As the economy completes its second year of expansion, brakes may have to be applied to check its forward momentum by allowing interest rates to rise.

How high must interest rates go to slow the economy significantly enough? No one, including Chairman Paul Volcker of the Federal Reserve Board, knows the magic level. Historical trends, however, are disconcerting. The prime rate had to rise to 6 percent in 1966, 8 percent in 1969, 12 percent in 1974 and 20.5 percent in 1981 in order to restrain the economy. If this trend continues, interest rates may have to rise substantially higher than the current levels to dampen economic vigor.

Debt Crisis

Higher interest rates are a double whammy for the debtor nations. Initially, debt-service burdens for these countries go up. Each percentage point increase in interest rate means additional debt-service obligation of $700 million for Brazil, or the amount of its entire annual shoe exports, and $400 million for Argentina, its total annual meat export. In addition, higher interest rates eventually hurt exports of the debtor nations by slowing down economic activities of industrialized countries. Higher interest costs and reduced foreign exchange earnings from exports make it more difficult for the borrowing nations to purchase necessary imports to keep the productive machineries of the country going, aggravating the declines in economic activity. Recent hikes in interest rates are having adverse consequences for the borrowers. As interest rates continue to trend upward, the economic impact on these nations will be more pronounced.

At the same time, social and political pressures are building in the debtor nations. In Latin America, the economies have contracted significantly with high jobless rates. Despite the severe recessions, the inflation picture has not improved. Large government deficits, rapid monetary expansion, reduced government subsidies and shortages of imported goods have kept prices rising at double and triple-digit rates.

The increasingly onerous debt burden in the face of deteriorating economic conditions has resulted in riots in large South American cities and elicited demands from local politicians and labor unions that external concerns be subordinated to domestic economic programs. To them, the issue is not the debt, but economic growth. Austerity measures, designed to satisfy the International Monetary Fund (IMF) and the international banks, are becoming increasingly unpopular. Under the circumstances, it is not surprising that we hear of a debtors' cartel. The idea for the cartel received a boost when four major borrowing countries — Brazil, Mexico, Argentina and Colombia — issued a joint statement requesting more lenient debt-repayment terms as well as greater trade concessions from the industrialized world.

REGIONAL ECONOMIC CONDITIONS

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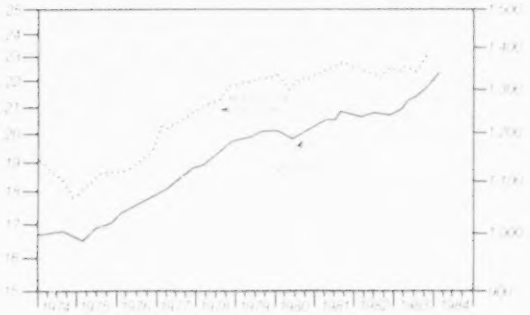
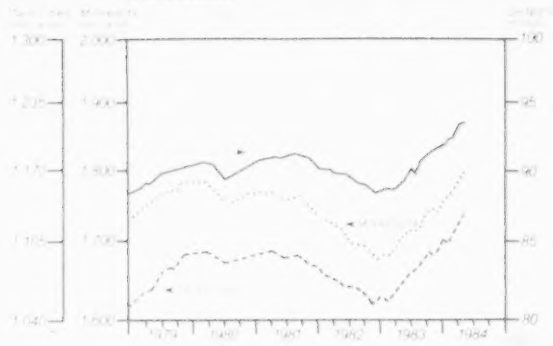
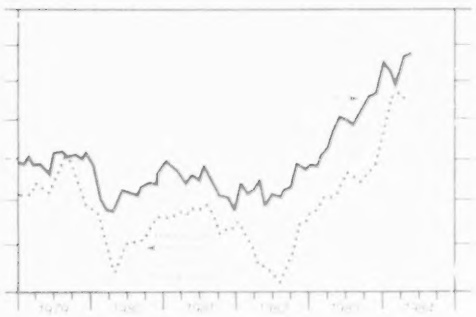
Real Personal Income



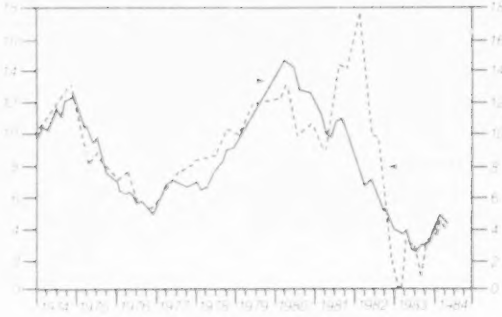
Nonfarm Employment



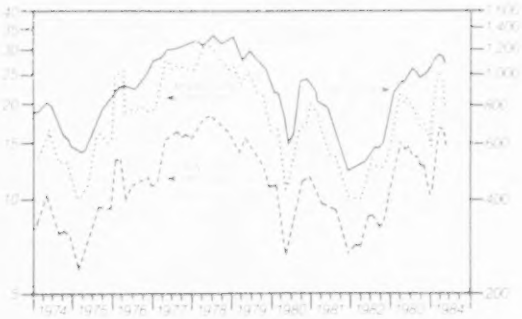
Real Retail Sales



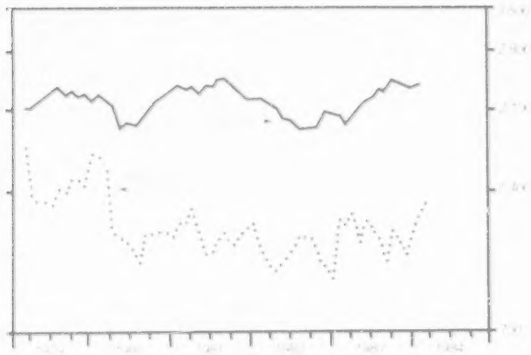
Consumer Price Index



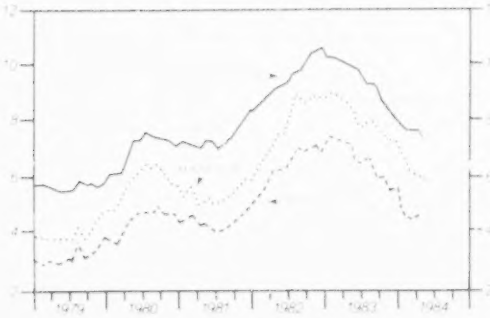
Housing Units Authorized



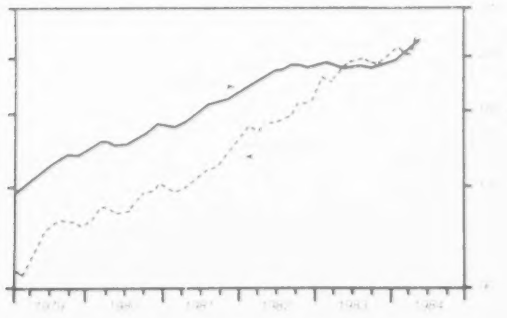
Total Private Nonresidential Construction



Unemployment Rates



Commercial and Industrial Loans



What matters is not only the **ability to pay.** Increasingly important is the **willingness to pay** by the debtor nations. This point was vividly demonstrated when, last March, Argentina won the first round of a "game of chicken." Since then, there has been no indication that Buenos Aires is any more willing to meet external obligations than it was before.

Outstanding Debt

	$ Billions
Argentina	45
Brazil	93
Mexico	90
Chile	19
Venezuela	36
Latin America	350
Developing Nations	700

What to Do

The current situation is very volatile and unstable. Extension of debt maturities and lending of additional funds to meet interest payments are not the best ways to solve fundamental debt problems.

What are the solutions to the long-term problems? Cutting through the veil of dollars and cents, the basic issue is the amount of real-resource transfer a debtor country is willing to accept voluntarily. In order to pay interest and amortize the outstanding debt, the borrower countries must give up some real resources to the lenders. As resources are transferred to lenders, the debtor's economy suffers, the unemployment rate rises, and social and political backlash to the transfer builds. The trick is to continue the resource transfer but, at the same time, minimize pain inflicted upon the populace.

How do we get out of the economic and political morass? One way is to reduce the size of the transfer by having the international banks reduce interest rates on outstanding foreign debt. The most dramatic approach is simply to "cap" interest rates on existing debt. The cap would be low enough to prevent the outstanding-debt level from rising and to allow the debtor country to have enough cash flow to import basic necessities for consumption and production. A variation of the scheme is capping of interest rates with either forgiveness or capitalization — adding to the debt principal outstanding the payments on interest rates exceeding the cap.

Another approach is to split the interest rates into "real" and "inflationary components, with the latter being capitalized. Upper and lower limits would be set. If interest rates rise above the upper limit, payments due in excess of the threshold would be added to the principal, while any fall of interest rates below the set floor would mean that the maturities would be shortened.

While the views vary greatly as to what concessions are possible and which are advisable, the emerging consensus is that some type of payment relief to the debtor nations is inevitable.

Economic Conditions

MEXICO: This is a success story from our point of view. Through sharp reductions in government deficits, slower monetary expansion and rapid devaluations, the economy has gone through a wringer, which prompted a severe recession. A sizeable portion of inflation has been squeezed out and the trade balance has improved significantly.

	1983	1984E
Real GDP (% change)	-4.7	1.0
Inflation Rate (%)	101.9	70.0
Current Acct. Bal. (Billions of $)	5.5	2.0

But the economic hardship is beginning to take a toll, and social pressure is becoming a real concern. In the coming year, the austerity measures are likely to be adjusted to stimulate the economy. The question is how. The government's ability to pump up the economy, without violating the IMF guidelines and sacrificing its hard-won credibility, is limited. Consequently, the government is courting the private sector, both domestic and foreign, to invest in Mexico. To encourage private investments, the government has initiated the payment of interest on bonds held by previous shareholders of nationalized banks, and the sale of some nationalized enterprises. The government is also providing preferential treatment to foreign capital invested in labor-intensive, export-oriented and import-substituting sectors. The government's sucess in attracting private capital will depend upon its ability to restore confidence among private investors in and out of Mexico.

Externally, Mexico depends heavily on oil exports, and the favorable trade balance has been achieved primarily through import controls. It is doubtful how far Mexico can go in holding down imports. No doubt some controls on imports will have to be relaxed to operate industries and satisfy some consumer demand.

BRAZIL: The economy continues to contract. Despite the economic declines, the inflation rate has accelerated. Only favorable news has come from the trade balance, which has exceeded expectations.

	1983	1984E
Real GDP (% change)	-3.3	-3.5
Inflation Rate (%)	155.0	230.0
Current Acct. Bal. (Billions of $)	7.7	6.0

The protracted recession is creating severe social and political problems for the government. Leaders of the various segments of the country are calling for the restimulation of the economy. The current situation requires a delicate balancing act for the government. On one hand, there is the need to honor the country's external commitments and, on the other, the need to prevent further deterioration of economic conditions at home. In coming months, domestic political considerations will play an increasingly important role in charting the future course of economic policy. This means that the austerity measures will be adjusted and the economy will be stimulated.

CHILE: President Pinochet has been willing to take tough economic measures to speed the economy toward health. Pleased with the performance, the IMF and international bankers have given their stamp of approval.

	1983	1984E
Real GDP (% change)	-1.0	4.0
Inflation Rate (%)	27.2	42.5
Current Acct. Bal. (Billions of $)	1.1	-2.0

Like its neighbors, Chile, too, is having problems with domestic social unrest, partly reflecting the dismal economic conditions. Politically, the cost of meeting the IMF target has been high. Public protests and riots in the streets have become frequent. In addition, Argentina's success in subordinating external considerations to domestic social needs has provided encouragement to Chile to follow more expansionary economic policies.

Economic restimulation means that the job picture will improve. However, the task of restoring the economy to health may take longer than anticipated.

ARGENTINA: Unlike her neighbors, this nation has enjoyed economic growth partly because the government has been unwilling to take tough steps to correct basic economic problems of inflation, high deficits and low confidence.

	1983	1984E
Real GDP (% change)	2.0	2.5
Inflation Rate (%)	344.8	1,000
Current Acct. Bal. (Billions of $)	1.7	1.0

The country has clearly put domestic social needs ahead of external obligations. At least for now, it has successfully shifted the burden of interest payments on foreign debt to other countries and financial institutions. The government has been operating under its own set of economic targets, which are not consistent with the IMF's.

One of the reasons behind the combative attitude of the Argentine government toward foreign debts is internal politics. The "Radical" government has locked horns with labor unions controlled by the Peronistas and finds it impossible to agree to the IMF conditions without opening itself up to charges by the political opposition. There already have been protest strikes, demonstrations, work stoppages and slowdowns throughout the country.

Under the circumstances, it is unlikely that the Alfonsin government would change its economic course. On a positive note, the Argentine attitude could become a catalyst in pushing the debtor nations and international banks toward a long-term solution.

VENEZUELA: This country, heavily dependent upon oil, has been hurt by the world oil glut. Per capita GDP has contracted every year since 1978. Since it is unlikely that the price and demand for oil will increase significantly, government spending and private investments are the two sources of economic stimulation. The government has moved to increase public employment, but the extent of government involvement is limited by its own austerity program. In order to encourage private investment, the government will have to restore confidence. Failure to do so will mean continued economic decline.

	1983	1984E
Real GDP (% change)	-3.5	0.5
Inflation Rate (%)	6.2	15.0
Current Acct. Bal. (Billions of $)	5.0	0.5

On the financial side, Venezuela needs to reschedule about $25 billion out of $36 billion in outstanding debts. However, the country has resisted an IMF economic-stabilization program. Instead, it is implementing its own austerity program as a substitute for the IMF program. Austerity measures are so unpopular that they cannot be seen as having been imposed from the outside. The Lusinchi government feels that Venezuela, with substantial international reserves, substantial oil income and no immediate need of new foreign loans, should be treated differently from its neighbors. In short, IMF participation is unnecessary.

Despite some complications, it is likely that an informal agreement between Caracas and commercial banks will be reached to restructure the debt and allow the economy to show modest growth this year. However, price increases will likely accelerate.

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ECONOMIC INDICATORS

CORPORATE ECONOMICS DEPARTMENT - DR. SUNG WON SOHN, CHIEF ECONOMIST SEPTEMBER 21, 1984

Economy Slowing, But Expansion Not Over Yet

The recent rallies in the financial markets were based on the expectation that the economy will slow significantly, the inflation picture will remain rosy and interest rates will start dropping soon. This is too good to be true. There are too many structural economic impediments to the optimistic assessment by the financial markets. Politicians in Washington are not likely to bite the bullet to find lasting solutions to the current economic dilemma.

Still Moving Forward. The economy has shown some signs of slowing from the torrid pace in the first half, but the overall picture is still one of ongoing expansion at a good clip. Consumers are borrowing and buying as if there were no tomorrow. Consumers typically go through three phases of a credit cycle: reliquification, accumulation and saturation. During the reliquification phase, consumers pay down debt and restore liquidity in their balance sheets. Once their financial house is in better shape, they begin to accumulate debt again to purchase big-ticket items. The third step is the saturation phase, where consumers have overextended themselves in relation to their income, and an economic downturn ensues. At the moment, consumers are in the second phase and still have considerable room for additional borrowing and spending.

Business spending also has been a significant factor in the current economic upswing. A lion's share of this year's economic growth has resulted from inventory accumulation. Even so, the inventory-to-sales ratio remains low, indicating businesses will have to add to their stocks unless sales fall off sharply. The best we can hope for is a slower rate of inventory accumulation, but not actual decumulation.

Capital spending by businesses has been another ingredient contributing to economic strength. Rising sales, ample cash flow, the desire to cut costs by raising productivity and the fear that Congress will take away some of the tax benefits enacted in 1981 have all contributed to robust capital spending. All indicators suggest that the trend will continue.

As usual, Uncle Sam has been an active participant in the spending spree. For example, after adjusting for inflation, defense spending rose at an annual rate of 13 percent in the second quarter of this year. True, the President has signed into

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Strong Dollar Reduces Inflation

The sterling performance of prices has surprised even the optimists. In fact, discussions of inflation have turned into talk of deflation–a decline in the overall price level, not just a drop for a few key commodities. The low inflation has also strengthened the position of supply-siders who believe that deficits will somehow fade away. Because of the good inflation experience, monetary policy has been more accommodative than it would have been otherwise.

Nobody other than perennial pessimists and a few monetarists, including Nobel Laureate Milton Friedman, thinks the inflation rate will return to a double-digit level anytime soon. However, that does not mean that price gains won't accelerate in the next year or so.

Strong Dollar Lowers Inflation. The stellar price picture at the moment is, to a significant extent, based on the strong dollar. Various empirical studies have concluded that if the dollar appreciates by 10 percent, the consumer price index will decline by 1.5 to 1.75 percentage points. About half of the total impact tends to take place within one year and the remainder within a 2 to 3 year period following the appreciation. Since June 1980 the dollar has appreciated close to 70 percent against other major trading currencies. Using the empirical results above, it is estimated that the current inflation rate would be 3 to 4 points higher than the current 4 percent if the dollar hadn't strengthened.

How does the strong dollar hold price increases in check? First, an appreciation of the dollar lowers the price of imports and prevents prices of import-competing goods manufactured here from rising as much as they would have otherwise. In addition, a lot of our manufactured goods use imported inputs, so cost increases are limited as the dollar rises.

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Economy Slowing

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law approximately $51 billion in tax increases and $10 billion in entitlement cuts, but this action will do little to stem the rise in the federal budget deficit, which will average close to $200 billion over the next two fiscal years. The rest of the downpayment package–which includes cuts in both defense and nondefense discretionary spending along with additional tax increases–must be enacted simply to keep the deficit from growing.

Economy Slows In 1985. In the face of substantial increases in credit demand from consumers, businesses and the federal government, the future course of economic activity will depend importantly upon monetary policy. Federal Reserve Chairman Volcker has been walking a tightrope. Economic numbers indicated that tighter monetary reins are necessary to dampen economic growth, but domestic politics and international debt argued against such a move.

In the immediate future, the Fed won't allow interest rates to rise significantly. However, once the election is over, interest rates are more likely to increase. The runup in interest rates will ultimately slow economic activity beginning with the interest–sensitive sectors of the economy. Big-ticket items, inventories and homebuilding will suffer first. If interest rates were to spike in 1985, a dramatic economic slowdown or possibly another recession could begin next year. More likely, interest rates will creep up gradually, postponing the day of reckoning beyond 1985.

NATIONAL ECONOMIC FORECAST

(Seasonally Adjusted Annual Rate)

		Real GNP	CPI	Corporate Profits*	Auto Sales	Housing Starts	Federal Deficit
		(% Change from prior period)			(Millions of Units)		($ billions)
1984	I	10.1	5.0	44.1	10.6	1.97	161
	II	7.6	3.7	30.2	10.7	1.90	167
	III	5.8	3.9	27.5	10.8	1.77	165
	IV	3.6	4.5	16.3	10.5	1.62	162
1983		3.7	3.2	15.6	9.2	1.70	179
1984		7.4	4.4	30.2	10.7	1.82	164
1985		2.3	6.2	5.1	10.3	1.50	197

*After Tax Profits.

Regional Recovery Not Strong For All

A solid upturn has been under way in the Upper Midwest since mid 1983, but employment is still nearly 3 percent below the peak reached in late 1979. The region has recouped about 60 percent of the jobs lost during the recession, while national employment is at an all-time high.

Large disparities prevail within the region, ranging from Iowa's poor showing to the Twin Cities' strong rebound.

The regional recovery should continue next year, but some industries and communities will remain well below prerecession levels. Business conditions will remain muted in many agricultural communities, while urban areas should fare considerably better.

Strong Consumer Spending. Retail sales in the Upper Midwest are up sharply from a year ago, surpassing the national performance. During the first half of 1984, auto sales posted a hefty 28 percent gain over last year. Nonauto sales are up nearly 12 percent. Even after adjusting for inflation, retail sales are at a record level. Unfortunately, this strong recovery is not indicative of conditions in smaller, rural communities.

Homebuilding has cooled considerably from the first quarter's strong performance. After outdistancing last year by 40 percent during the first quarter, regional housing permits in May and June were down 10 to 15 percent from 1983's level, a sharper drop than nationally. Even so, permits issued during the first half of 1984 still averaged 9 percent more than in 1983, slightly less than the 13 percent gain nationwide.

Despite the recent slowdown, regional homebuilding still is about 50 percent higher than 1982's level. However, compared with the housing boom in 1977 and 1978, the region has not recovered as much as the nation. Within the region, the Twin Cities comes the closest to the boom level experienced during the late 1970s.

Employment Significantly Below Peak. Regional nonfarm employment is up 3.5 percent from a year ago, trailing the nation's 4.6 percent gain. After spurting ahead during the first quarter, regional employment faltered as three states experienced declines in the second quarter. This slower recovery, combined with a more serious recession, has kept regional employment 2.7 percent below the previous peak, while national employment is 3.2 percent above the peak reached before the last recession.

Regional construction employment rebounded much less than nationally during the past 12 months. This left construction employment about 25 percent below the previous peak, while the nation is only 5 percent short of its prerecession level. The completion of several large projects led to a drop in con-

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NONFARM EMPLOYMENT TRENDS — AS OF JULY 1984

	Employment Level	Percent Change From Peak Before Last Recession	Percent Change From Year Ago
Iowa	1,023,400	–9.4%	1.3%
Montana	272,400	–6.7%	1.3
Wisconsin	1,918,300	–3.7	3.4
Nebraska	625,900	–1.9	2.7
North Dakota	251,900	–1.5	0.1
South Dakota	243,700	–0.7	2.9
Minnesota	1,819,700	1.7	6.0
Twin Cities	1,134,200	3.5	5.6
Other Minn.	685,500	–1.6	6.7
7-State Region	6,155,300	–2.7	3.5
United States	94,264,000	3.2	4.6

Agriculture Faces Increased Difficulties

There's good news and bad news on the regional economic scene. Latest figures indicate that the economic recovery in the Upper Midwest will continue into 1985, with urban areas faring particularly well. The picture for agriculture, however, is not as encouraging.

The agricultural industry appears headed for increased financial difficulty, with crop prices declining as corn and soybean production rebounds from last year's drought and reduced acreage. Lower prices could persist for some time. And although livestock producers will benefit from lower feed costs, the agricultural industry in general won't experience the economic improvement that has swept the country during the past year.

Highly-leveraged operators will continue to experience cash flow problems and declining net worth. The shake-out of these operators will continue, causing land prices to drift somewhat lower, although the biggest decline in land values probably already has occurred.

Despite this rather gloomy agricultural economic environment, a number of farmers–those with moderate debt loads–will continue to experience positive earnings. However, a cautious attitude will still prompt these financially strong producers to continue to restrict capital outlays.

Inventory Rebuilding Assured. Although U.S. corn and soybean production will fall short of record levels, supplies will be ample enough to start rebuilding depleted inventories. Corn inventories are projected to increase from about 650 million bushels this fall to 1.2 billion bushels before the 1985 harvest. Ending soybean inventories should rebound from 115 million bushels this September to more than 200 million bushels next year. Although corn and soybean carryover inventories may nearly double during the next year, they will remain well below last fall's record level.

Corn and soybean prices have already declined considerably from last year's drought-inflated level, and lower prices could prevail for some time. Chicago corn prices are likely to hover around the loan rate ($2.55 a bushel) this fall and then strengthen modestly, with the 1984-85 season average price dropping about 70 cents a bushel from 1983-84. Deficiency payments will cushion the decline. Soybean prices are projected to average about 80 cents a bushel less than in 1983-84. However, a much greater discrepancy will exist during the harvest quarter.

CROP PRICES — CASH MARKETS

(Dollars Per Bushel)

	Corn Prices Chicago		Soybean Prices Chicago			Wheat Prices Kansas City	
Quarter	1983-84	1984-85	1983-84	1984-85	Quarter	1983-84	1984-85
IV	3.45	2.60	8.14	6.25	III	3.83	3.75
I	3.37	2.75	7.51	6.85	IV	3.84	3.85
II	3.61	2.85	8.13	7.25	I	3.79	3.80
III	3.30	2.75	6.50	6.65	II	3.81	3.75
Season Average	3.43	2.75	7.57	6.75	Season Average	3.83	3.79

Record World Grain Production. Despite adverse weather in key countries, record world grain production is still forecast in 1984-85. A sharp rebound in U.S. corn production will more than offset a poor Soviet feed-grain harvest. Worldwide feed-grain inventories will head upward again, following the sharp drop this past year.

Record wheat output is anticipated in China and the European Community, neutralizing reduced Canadian production. Canada may have the smallest wheat crop in four years. Another boost in world wheat consumption will limit the rise in world wheat inventories. Even so, wheat supplies will remain abundant, keeping prices under pressure. Durum and other spring wheat producers will fare somewhat better as tight free-market stocks support prices.

Despite increased U.S. production, wheat inventories will decline modestly from current lofty levels. Durum and other spring wheat will account for much of the inventory reduction because of heavy farm-program participation.

Demand Muted Despite Soviet Buying. One of the bright spots for the crop sector has been aggressive Soviet buying this summer, reflecting another poor Soviet harvest. So far, the Soviets have purchased about 14 million metric tons of wheat and corn for the year ending Sept. 30, 1984. Many analysts expect Soviet grain purchases to reach 12 to 20 million tons during the coming year.

Thus far, the Soviet purchases have had little impact on corn prices, but additional purchases should have a more supportive effect. Nevertheless, a strong dollar and Third-World debt problems will limit the overall rebound in U.S. agricultural exports.

Elusive Hog Feeding Profits. The hog breeding inventory is down sharply from a year ago and, starting about mid year, pork production has been significantly lower than a year ago. Yet hog prices have not responded.

Hog prices increased from about $47 per hundred pounds in May to $55 in July, but then dipped below $50 in late August. Large inventories of frozen pork combined with sharply higher imports from Canada have kept hog prices under pressure.

Farmers may be altering their production plans in response to the latest price break. During the past month or so, sow slaughter has reached a level that suggests producers are further reducing their hog-breeding herd. The USDA hog report, to be released this month, will shed more light on farmers' plans. Evidence of additional liquidation would be constructive for prices late this year and into 1985.

Livestock Profits Should Improve. Cattle-feeding margins narrowed consid-

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INVENTORIES AT END OF MARKETING SEASON

(Millions of bushels)

Crop Year	Corn	Soybeans	Wheat
1978-79	1,304	176	924
1979-80	1,617	358	902
1980-81	1,034	313	989
1981-82	2,174	254	1,159
1982-83	3,120	345	1,515
1983-84	650	115	1,394
1984-85	1,219	205	1,333

Strong Dollar

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As the relative price of domestic to foreign goods shifts in favor of imports, exports suffer and imports benefit. Since domestic demand is met more by imports, pressures on domestic productive capacity and labor are lessened. With abundant excess capacity abroad and less expensive imports, rising capacity–utilization rates and employment at home do not automatically lead to higher prices and wages. For example, domestic industries such as paper, rubber, plastics and electric machinery have been operating at full capacity. But foreign competition has kept price increases quite modest in these areas.

The strong dollar also has an impact on interest rates. Holding other things constant, the negative effect of the dollar appreciation on exports implies that aggregate demand is lower. Lower aggregate demand means lower demand for money. If the supply of money is held constant, interest rates should drop. During the 1980-1984 period, however, money supply (M1) has grown at an annual rate of 8.8 percent, a hefty growth rate. In other words, the strengthening dollar partly explains the declining trend in interest rates during the period.

Higher Inflation in 1985. The favorable inflation pattern will not last indefinitely. From an economic policy perspective, federal deficits will continue to add to inflation and inflation psychology. Monetary policy has not and will not be as restrictive as it should be because of domestic politics and international debt considerations. In addition, pending labor–contract settlements, a weakening dollar and rising capacity utilization at home and abroad will all heighten inflationary pressures. Thus, although remaining well below double-digit levels, inflation indices will creep upward next year, averaging about 6 percent.

Regional Recovery

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struction jobs in North Dakota and Montana this year.

Manufacturing employment growth in the region has been about on par with the nation during 1984. Even so, regional manufacturing employment is still 12 percent below the peak reached in 1979, a larger shortfall than nationally. Manufacturing jobs are still down more than 20 percent in Iowa and Montana, but South Dakota's manufacturing activity is at a record level and the Twin Cities is close to its previous peak.

Large Disparities Within Region. The regional recovery has been extremely uneven geographically. Urban areas typically have enjoyed healthier economic conditions than most rural communities.

The Twin Cities economy is roaring ahead, surpassing the national performance. Twin Cities employment is now 3.5 percent above the previous peak. Job gains have been widespread, but the largest increases have come from construction, transportation, retail trade, business services and durable-goods manufacturing–especially computers and other high-tech items.

Posting the second strongest recovery in the region, South Dakota is approaching pre-recession levels. Employment in Sioux Falls is up 8.5 percent from a year ago, accounting for nearly 40 percent of the state's growth.

Other states in the region remain below pre-recession levels of employment. Iowa's employment is 9.4 percent below the previous peak, by far the weakest recovery in the region. Heavy dependence on farming, meat packing and farm machinery manufacturing has hindered Iowa's economic recovery.

Montana posted the second weakest showing, with employment still 6.7 percent below the 1979 peak. Employment is still down 3.7 percent in Wisconsin, while Nebraska and North Dakota are nearly 2 percent below pre-recession levels.

Ag Difficulties

(continued from page 3)

erably from favorable levels earlier this year. This diminished profitability was a result of lower cattle prices and high feed costs, which have only recently receded.

Lower beef and pork production is expected in1985, particularly in the first half of the year. The drop in red meat supplies should more than offset increased poultry output. Declining meat production should boost livestock prices. Better prices, combined with lower feed costs, should significalty boost livestock-feeding profits in 1985.

Improved profitability will eventually lead to another upturn in hog numbers, but the initial buildup of the breeding herd will further support prices as fewer animals are sent to market. Larger supplies would not begin to pressure hog prices until late 1985.

LIVESTOCK PRICES

(Dollars Per Hundredweight)

	Hog Prices 7-Major Markets			Choice Steers Omaha		
Quarter	**1983**	**1984**	**1985**	**1983**	**1984**	**1985**
I	55.02	47.68	54.00	61.54	67.58	68.00
II	46.74	48.91	55.00	67.04	66.00	68.00
III	46.90	51.25		60.89	64.50	
IV	42.18	50.00		60.61	65.00	

Dairy Problem Persists. The dairy diversion program will cut milk production by about 3 percent this year. This reduction along with increased consumption is reducing government purchases of surplus dairy products. Nevertheless, government purchases will remain at a level that will trigger additional cuts in milk price supports next year. The support price is expected to decline 50 cents per hundredweight on April 1, 1985, and another 50 cents on July 1, 1985, to $11.60 per hundredweight.

After the diversion program ends, cow numbers will begin to rise. However, lower price supports will limit the increase. This will result in rising milk output in 1986, increasing government purchases of dairy products. While the diversion program will have helped alleviate excess production for 1984 and 1985, the underlying problem remains unresolved. Current indications are that the supply problem will be addressd by lowering price support levels.

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